SOUTH JERSEY INDUSTRIES INC
Form 10-Q
November 07, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
(Mark one)

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

For the quarterly period ended September 30, 2018

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	Exact name of registrant as specified in its charter and principal office address and telephone number	State of Incorporation	I.R.S. Employer Identification No.
1-6364	South Jersey Industries, Inc. 1 South Jersey Plaza Folsom, NJ 08037 (609) 561-9000	New Jersey	22-1901645
000-22211	South Jersey Gas Company 1 South Jersey Plaza Folsom, NJ 08037 (609) 561-9000	New Jersey	21-0398330

Indicate by check mark whether each 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 such 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 each 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 such registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether each registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

South Jersey Industries, Inc.:

Large accelerated filer	x	Accelerated filer	o	Non-accelerated filer	o
Smaller reporting company	o	Emerging growth company	o		

South Jersey Gas Company:

Large accelerated filer	o	Accelerated filer	o	Non-accelerated filer	x
Smaller reporting company	o	Emerging growth company	o		

If an emerging growth company, indicate by check mark if either registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section

13(a) of the Exchange Act o

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

South Jersey Industries, Inc. (SJI) common stock ($1.25 par value) outstanding as of November 1, 2018 was 85,506,217 shares. South Jersey Gas Company common stock ($2.50 par value) outstanding as of November 1, 2018 was 2,339,139 shares. All of South Jersey Gas Company's outstanding shares of common stock are held by SJI Utilities, Inc, which is a wholly-owned subsidiary of SJI.

South Jersey Gas Company is a wholly-owned subsidiary of SJI Utilities, Inc. and meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q. As such, South Jersey Gas Company files its Quarterly Report on Form 10-Q with the reduced disclosure format authorized by General Instruction H.

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INTRODUCTION

FILING FORMAT

This Quarterly Report on Form 10-Q is a combined report being filed separately by two registrants: South Jersey Industries, Inc. (SJI) and South Jersey Gas Company (SJG). Information relating to SJI or any of its subsidiaries, other than SJG, is filed by SJI on its own behalf. SJG is only responsible for information about itself.

Except where the content clearly indicates otherwise, any reference in the report to "SJI," "the Company," "we," "us" or "our" is to the holding company or SJI and all of its subsidiaries, including SJG, which is a wholly-owned subsidiary of SJI Utilities, Inc. (which is wholly-owned by SJI).

Part 1 - Financial information in this Quarterly Report on Form 10-Q includes separate financial statements (i.e., balance sheets, statements of income, statements of comprehensive income and statements of cash flows) for SJI and SJG. The Notes to Unaudited Condensed Consolidated Financial Statements are presented on a combined basis for both SJI and SJG. Management's Discussion and Analysis of Financial Condition and Results of Operations (Management's Discussion) included under Item 2 is divided into two major sections: SJI and SJG.

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Item 1. Unaudited Condensed Consolidated Financial Statements

SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(In Thousands Except for Per Share Data)

	Three Months Ended September 30,	
	2018	2017
Operating Revenues (See Note 16):		
Utility	$85,478	$65,473
Nonutility	217,002	161,654
Total Operating Revenues	302,480	227,127
Operating Expenses:		
Cost of Sales - (Excluding depreciation and amortization)		
- Utility	23,238	28,217
- Nonutility	209,874	140,598
Operations (See Note 1)	74,413	37,377
Impairment Charges (See Note 1)	—	43,966
Maintenance	8,602	4,615
Depreciation	22,350	24,914
Energy and Other Taxes	2,595	1,517
Total Operating Expenses	341,072	281,204
Operating Loss (See Note 1)	(38,592)	(54,077)
Other Income and Expense (See Note 1)	1,406	1,075
Interest Charges	(26,534)	(10,567)
Loss Before Income Taxes	(63,720)	(63,569)
Income Taxes	16,649	24,765
Equity in Earnings of Affiliated Companies	1,429	1,256
Loss from Continuing Operations	(45,642)	(37,548)
Loss from Discontinued Operations - (Net of tax benefit)	(43)	(45)
Net Loss	$(45,685)	$(37,593)
Basic Earnings Per Common Share:		
Continuing Operations	$(0.53)	$(0.47)
Discontinued Operations	—	—
Basic Earnings Per Common Share	$(0.53)	$(0.47)
Average Shares of Common Stock Outstanding - Basic	85,506	79,549
Diluted Earnings Per Common Share:		
Continuing Operations	$(0.53)	$(0.47)
Discontinued Operations	—	—
Diluted Earnings Per Common Share	$(0.53)	$(0.47)
Average Shares of Common Stock Outstanding - Diluted	85,506	79,549
Dividends Declared Per Common Share	$0.28	$0.27

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

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	Nine Months Ended September 30, 2018	2017
Operating Revenues (See Note 16):		
Utility	$392,849	$343,180
Nonutility	658,906	554,150
Total Operating Revenues	1,051,755	897,330
Operating Expenses:		
Cost of Sales - (Excluding depreciation and amortization)		
- Utility	128,536	131,927
- Nonutility	533,440	503,715
Operations (See Note 1)	179,464	112,865
Impairment Charges (See Note 1)	99,233	44,221
Maintenance	22,276	14,268
Depreciation	71,783	73,793
Energy and Other Taxes	6,277	5,139
Total Operating Expenses	1,041,009	885,928
Operating Income (See Note 1)	10,746	11,402
Other Income and Expense (See Note 1)	5,141	6,700
Interest Charges	(60,067)	(38,291)
Loss Before Income Taxes	(44,180)	(20,189)
Income Taxes	12,206	8,439
Equity in Earnings of Affiliated Companies	3,845	4,337
Loss from Continuing Operations	(28,129)	(7,413)
Loss from Discontinued Operations - (Net of tax benefit)	(135)	(122)
Net Loss	$(28,264)	$(7,535)
Basic Earnings Per Common Share:		
Continuing Operations	$(0.34)	$(0.09)
Discontinued Operations	—	—
Basic Earnings Per Common Share	$(0.34)	$(0.09)
Average Shares of Common Stock Outstanding - Basic	83,082	79,539
Diluted Earnings Per Common Share:		
Continuing Operations	$(0.34)	$(0.09)
Discontinued Operations	—	—
Diluted Earnings Per Common Share	$(0.34)	$(0.09)
Average Shares of Common Stock Outstanding - Diluted	83,082	79,539
Dividends Declared per Common Share	$0.84	$0.81

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

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SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(In Thousands)

	Three Months Ended September 30,	
	2018	2017
Net Loss	$(45,685)	$(37,593)
Other Comprehensive Income, Net of Tax:*		
Unrealized Gain on Derivatives - Other	8	7
Other Comprehensive Income - Net of Tax*	8	7
Comprehensive Loss	$(45,677)	$(37,586)

	Nine Months Ended September 30,	
	2018	2017
Net Loss	$(28,264)	$(7,535)
Other Comprehensive Income, Net of Tax:*		
Unrealized Gain on Derivatives - Other	25	1,529
Other Comprehensive Income - Net of Tax*	25	1,529
Comprehensive Loss	$(28,239)	$(6,006)

* Determined using a combined average statutory tax rate of approximately 27% and 40% in 2018 and 2017, respectively.

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

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SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In Thousands)

	Nine Months Ended September 30, 2018	2017
Net Cash Provided by Operating Activities	$173,396	$127,081
Cash Flows from Investing Activities:		
Capital Expenditures	(200,770)	(205,604)
Cash Paid for Acquisition, Net of Cash Acquired	(1,740,375)	—
Cash Paid for Purchase of New Contract	(11,389)	—
Proceeds from Sale of Property, Plant & Equipment	51	3,547
Investment in Long-Term Receivables	(6,167)	(6,670)
Proceeds from Long-Term Receivables	7,414	7,468
Notes Receivable	—	3,000
Purchase of Company-Owned Life Insurance	(1,148)	(8,765)
Investment in Affiliate	(9,524)	(22,434)
Net Repayment of Notes Receivable - Affiliate	1,360	41
Net Cash Used in Investing Activities	(1,960,548)	(229,417)
Cash Flows from Financing Activities:		
Net Borrowings from (Repayments of) Short-Term Credit Facilities	75,000	(16,000)
Proceeds from Issuance of Long-Term Debt	1,592,500	446,000
Principal Repayments of Long-Term Debt	(10,000)	(292,400)
Payments for Issuance of Long-Term Debt	(16,914)	(3,744)
Net Settlement of Restricted Stock	(776)	(751)
Dividends on Common Stock	(46,233)	(43,353)
Proceeds from Sale of Common Stock	173,750	—
Payments for the Issuance of Common Stock	(6,554)	—
Net Cash Provided by Financing Activities	1,760,773	89,752
Net Decrease in Cash, Cash Equivalents and Restricted Cash	(26,379)	(12,584)
Cash, Cash Equivalents and Restricted Cash at Beginning of Period	39,695	31,910
Cash, Cash Equivalents and Restricted Cash at End of Period	$13,316	$19,326

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

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

	September 30, 2018	December 31, 2017
Assets		
Property, Plant and Equipment:		
Utility Plant, at original cost	$ 4,200,565	$ 2,652,244
Accumulated Depreciation	(781,824)	(498,161)
Nonutility Property and Equipment, at cost	161,250	741,027
Accumulated Depreciation	(49,888)	(194,913)
Property, Plant and Equipment - Net	3,530,103	2,700,197
Investments:		
Available-for-Sale Securities	36	36
Restricted	10,002	31,876
Investment in Affiliates	74,811	62,292
Total Investments	84,849	94,204
Current Assets:		
Cash and Cash Equivalents	3,314	7,819
Accounts Receivable	220,561	202,379
Unbilled Revenues	29,313	73,377
Provision for Uncollectibles	(20,292)	(13,988)
Notes Receivable - Affiliate	3,552	4,913
Natural Gas in Storage, average cost	84,373	48,513
Materials and Supplies, average cost	4,574	4,239
Prepaid Taxes	28,185	41,355
Derivatives - Energy Related Assets	27,414	42,139
Assets Held For Sale	329,622	—
Other Prepayments and Current Assets	26,703	28,247
Total Current Assets	737,319	438,993
Regulatory and Other Noncurrent Assets:		
Regulatory Assets	628,977	469,224
Derivatives - Energy Related Assets	8,014	5,988
Notes Receivable - Affiliate	13,275	13,275
Contract Receivables	27,934	28,721
Goodwill	759,826	3,578
Other (See Note 1)	124,225	110,906
Total Regulatory and Other Noncurrent Assets	1,562,251	631,692
Total Assets	$ 5,914,522	$ 3,865,086

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

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

	September 30, 2018	December 31, 2017
Capitalization and Liabilities		
Equity:		
Common Stock	$ 106,883	$ 99,436
Premium on Common Stock	843,064	709,658
Treasury Stock (at par)	(287)	(271)
Accumulated Other Comprehensive Loss	(36,740)	(36,765)
Retained Earnings	321,912	420,351
Total Equity	1,234,832	1,192,409
Long-Term Debt	1,281,000	1,122,999
Total Capitalization	2,515,832	2,315,408
Current Liabilities:		
Notes Payable	421,400	346,400
Current Portion of Long-Term Debt	1,482,734	63,809
Accounts Payable	383,465	284,899
Customer Deposits and Credit Balances	35,109	43,398
Environmental Remediation Costs	59,799	66,372
Taxes Accrued	3,924	2,932
Derivatives - Energy Related Liabilities	23,469	46,938
Deferred Contract Revenues	407	259
Derivatives - Other Current	339	748
Dividends Payable	23,942	—
Interest Accrued	12,125	9,079
Pension Benefits	2,388	2,388
Other Current Liabilities	22,053	15,860
Total Current Liabilities	2,471,154	883,082
Deferred Credits and Other Noncurrent Liabilities:		
Deferred Income Taxes - Net	85,840	86,884
Pension and Other Postretirement Benefits	114,765	101,544
Environmental Remediation Costs	163,047	106,483
Asset Retirement Obligations	44,255	59,497
Derivatives - Energy Related Liabilities	3,997	6,025
Derivatives - Other Noncurrent	5,125	9,622
Regulatory Liabilities	481,512	287,105
Other	28,995	9,436
Total Deferred Credits and Other Noncurrent Liabilities	927,536	666,596
Commitments and Contingencies (Note 11)		

Total Capitalization and Liabilities	$ 5,914,522	$ 3,865,086

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

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SOUTH JERSEY GAS COMPANY
CONDENSED STATEMENTS OF INCOME (UNAUDITED)
(In Thousands)

	Three Months Ended September 30,	
	2018	2017
Operating Revenues (See Note 16)	$56,371	$66,755
Operating Expenses:		
Cost of Sales (Excluding depreciation and amortization)	16,079	29,499
Operations (See Note 1)	24,536	22,599
Maintenance	6,892	4,615
Depreciation	14,703	13,226
Energy and Other Taxes	988	865
Total Operating Expenses	63,198	70,804
Operating Loss (See Note 1)	(6,827)	(4,049)
Other Income and Expense (See Note 1)	2,141	1,027
Interest Charges	(7,108)	(6,437)
Loss Before Income Taxes	(11,794)	(9,459)
Income Taxes	2,818	3,688
Net Loss	$(8,976)	$(5,771)

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

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	Nine Months Ended September 30,	
	2018	2017
Operating Revenues (See Note 16)	$367,631	$346,820
Operating Expenses:		
Cost of Sales (Excluding depreciation and amortization)	125,266	135,567
Operations (See Note 1)	81,174	69,229
Maintenance	20,566	14,268
Depreciation	43,467	38,813
Energy and Other Taxes	2,741	3,032
Total Operating Expenses	273,214	260,909
Operating Income (See Note 1)	94,417	85,911
Other Income and Expense (See Note 1)	5,258	3,108
Interest Charges	(20,835)	(18,392)
Income Before Income Taxes	78,840	70,627
Income Taxes	(19,500)	(27,654)
Net Income	$59,340	$42,973

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

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SOUTH JERSEY GAS COMPANY
CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(In Thousands)

	Three Months Ended September 30,	
	2018	2017
Net Loss	$(8,976)	$(5,771)
Other Comprehensive Income - Net of Tax: *		
Unrealized Gain on Derivatives - Other	8	7
Other Comprehensive Income - Net of Tax *	8	7
Comprehensive Loss	$(8,968)	$(5,764)

	Nine Months Ended September 30,	
	2018	2017
Net Income	$59,340	$42,973
Other Comprehensive Income - Net of Tax: *		
Unrealized Gain on Derivatives - Other	25	21
Other Comprehensive Income - Net of Tax *	25	21
Comprehensive Income	$59,365	$42,994

* Determined using a combined average statutory tax rate of approximately 27% and 40% in 2018 and 2017, respectively.

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

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SOUTH JERSEY GAS COMPANY
CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In Thousands)

	Nine Months Ended September 30,	
	2018	2017
Net Cash Provided by Operating Activities	$86,788	$73,186
Cash Flows from Investing Activities:		
Capital Expenditures	(168,654)	(183,875)
Purchase of Company-Owned Life Insurance	—	(4,875)
Investment in Long-Term Receivables	(6,167)	(6,670)
Proceeds from Long-Term Receivables	7,414	7,468
Net Cash Used in Investing Activities	(167,407)	(187,952)
Cash Flows from Financing Activities:		
Net Borrowings from (Repayments of) Short-Term Credit Facilities	88,200	(104,300)
Proceeds from Issuance of Long-Term Debt	—	396,000
Principal Repayments of Long-Term Debt	(10,000)	(215,000)
Payments for Issuance of Long-Term Debt	(21)	(2,030)
Additional Investment by Shareholder	—	40,000
Net Cash Provided by Financing Activities	78,179	114,670
Net Decrease in Cash, Cash Equivalents and Restricted Cash	(2,440)	(96)
Cash, Cash Equivalents and Restricted Cash at Beginning of Period	4,619	1,391
Cash, Cash Equivalents and Restricted Cash at End of Period	$2,179	$1,295

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

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SOUTH JERSEY GAS COMPANY
CONDENSED BALANCE SHEETS (UNAUDITED)
(In Thousands)

	September 30, 2018	December 31, 2017
Assets		
Property, Plant and Equipment:		
Utility Plant, at original cost	$ 2,812,128	$ 2,652,244
Accumulated Depreciation	(519,924)	(498,161)
Property, Plant and Equipment - Net	2,292,204	2,154,083
Investments:		
Restricted Investments	532	2,912
Total Investments	532	2,912
Current Assets:		
Cash and Cash Equivalents	1,647	1,707
Accounts Receivable	72,010	78,571
Accounts Receivable - Related Parties	2,235	988
Unbilled Revenues	7,995	54,980
Provision for Uncollectibles	(14,327)	(13,799)
Natural Gas in Storage, average cost	19,629	14,932
Materials and Supplies, average cost	706	825
Prepaid Taxes	25,667	38,326
Derivatives - Energy Related Assets	7,951	7,327
Other Prepayments and Current Assets	10,498	12,670
Total Current Assets	134,011	196,527
Regulatory and Other Noncurrent Assets:		
Regulatory Assets	494,331	469,224
Long-Term Receivables	25,390	25,851
Derivatives - Energy Related Assets	2	5
Other	19,914	17,372
Total Regulatory and Other Noncurrent Assets	539,637	512,452
Total Assets	$ 2,966,384	$ 2,865,974

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

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SOUTH JERSEY GAS COMPANY
CONDENSED BALANCE SHEETS (UNAUDITED)
(In Thousands, except per shareamounts)

	September 30, 2018	December 31, 2017
Capitalization and Liabilities		
Equity:		
Common Stock	$ 5,848	$ 5,848
Other Paid-In Capital and Premium on Common Stock	355,744	355,744
Accumulated Other Comprehensive Loss	(25,972)	(25,997)
Retained Earnings	645,177	585,838
Total Equity	980,797	921,433
Long-Term Debt	573,441	758,052
Total Capitalization	1,554,238	1,679,485
Current Liabilities:		
Notes Payable	140,200	52,000
Current Portion of Long-Term Debt	238,909	63,809
Accounts Payable - Commodity	30,365	43,341
Accounts Payable - Other	49,654	41,365
Accounts Payable - Related Parties	7,090	17,029
Derivatives - Energy Related Liabilities	2,804	9,270
Derivatives - Other Current	291	389
Customer Deposits and Credit Balances	27,051	41,656
Environmental Remediation Costs	40,682	66,040
Taxes Accrued	1,665	1,760
Pension Benefits	2,353	2,353
Interest Accrued	4,832	7,615
Other Current Liabilities	6,066	7,027
Total Current Liabilities	551,962	353,654
Regulatory and Other Noncurrent Liabilities:		
Regulatory Liabilities	290,033	287,105
Deferred Income Taxes - Net	311,274	280,746
Environmental Remediation Costs	111,298	105,656
Asset Retirement Obligations	43,451	58,714
Pension and Other Postretirement Benefits	94,305	88,871
Derivatives - Energy Related Liabilities	68	170
Derivatives - Other Noncurrent	4,751	6,639
Other	5,004	4,934
Total Regulatory and Other Noncurrent Liabilities	860,184	832,835
Commitments and Contingencies (Note 11)		

Total Capitalization and Liabilities	$ 2,966,384	$ 2,865,974

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

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Notes to Unaudited Condensed Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

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

SJI Utilities, Inc. (SJIU) is a holding company that owns South Jersey Gas Company ("SJG"), and, as of July 1, 2018, Elizabethtown Gas Company ("ETG") and Elkton Gas Company ("ELK") (see "Acquisition" below).

* SJG is a regulated natural gas utility which distributes natural gas in the seven southernmost counties of New Jersey.

* ETG is a regulated natural gas utility which distributes natural gas in seven counties in northern and central New Jersey.

* ELK is a regulated natural gas utility which distributes natural gas in northern Maryland.

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

South Jersey Resources Group, LLC (SJRG) markets natural gas storage, commodity and transportation assets along with fuel management services on a wholesale basis in the mid-Atlantic, Appalachian and southern states.

South Jersey Exploration, LLC (SJEX) owns oil, gas and mineral rights in the Marcellus Shale region of Pennsylvania.

Marina Energy, LLC (Marina) develops and operates on-site energy-related projects. It currently operates projects in New Jersey, Maryland, Massachusetts and Vermont. The significant wholly-owned subsidiaries of Marina include:

• ACB Energy Partners, LLC (ACB) owns and operates a natural gas fueled combined heating, cooling and power facility located in Atlantic City, New Jersey.

• AC Landfill Energy, LLC (ACLE), BC Landfill Energy, LLC (BCLE), SC Landfill Energy, LLC (SCLE) and SX Landfill Energy, LLC (SXLE) own and operate landfill gas-to-energy production facilities in Atlantic, Burlington, Salem and Sussex Counties located in New Jersey.

• MCS Energy Partners, LLC (MCS), NBS Energy Partners, LLC (NBS) and SBS Energy Partners, LLC (SBS) own and operate solar-generation sites located in New Jersey. These entities were sold in October 2018 (see Note 18).

South Jersey Energy Service Plus, LLC (SJESP) serviced residential and small commercial HVAC systems, installed small commercial HVAC systems, provided plumbing services and serviced appliances under warranty via a subcontractor arrangement as well as on a time and materials basis. On September 1, 2017, SJESP sold certain assets of its residential and small commercial HVAC and plumbing business to a third party. SJESP continues to receive commissions paid on service contracts from the third party and will do so on a going forward basis.

SJI Midstream, LLC (Midstream) invests in infrastructure and other midstream projects, including a current project to build an approximately 118-mile natural gas pipeline in Pennsylvania and New Jersey.

BASIS OF PRESENTATION - SJI's condensed consolidated financial statements include the accounts of SJI, its wholly-owned subsidiaries (including SJG) and subsidiaries in which SJI has a controlling interest. All significant intercompany accounts and transactions have been eliminated in consolidation. Beginning as of the date of their acquisition, July 1, 2018, SJI is reporting on a consolidated basis the combined operations of ETG and ELK, along with its other wholly-owned and controlled subsidiaries.

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As permitted by the rules and regulations of the Securities and Exchange Commission (SEC), the accompanying unaudited condensed consolidated financial statements of SJI and SJG contain certain condensed financial information and exclude certain footnote disclosures normally included in annual audited consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These financial statements should be read in conjunction with SJI’s and SJG's Annual Reports on Form 10-K for the year ended December 31, 2017. In management’s opinion, the unaudited condensed consolidated financial statements of SJI and SJG reflect all normal recurring adjustments needed to fairly present their respective financial positions, operating results and cash flows at the dates and for the periods presented. SJI’s and SJG's businesses are subject to seasonal fluctuations and, accordingly, this interim financial information should not be the basis for estimating the full year’s operating results.

Certain reclassifications have been made to SJI's and SJG's prior period unaudited condensed consolidated statements of income to conform to the current period presentation, as follows:

- The non-service cost components of net periodic pension and postretirement benefit costs are now included as a reduction to Other Income and Expense, as opposed to being recorded as an Operations Expense, to conform with ASU 2017-07, which is described below under "New Accounting Pronouncements." This caused a reduction to both Operations Expense and Other Income on the unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2017. This also caused a reclassification to SJI's prior period segments disclosure in Note 6 to increase Operating Income within both the Gas Utility Operations and Corporate & Services segments for the three and nine months ended September 30, 2017.

- Impairment Charges, which were previously presented as part of Operations Expense, are now presented as a separate line item under Operating Expenses in the unaudited condensed consolidated statements of income. This caused a reduction to Operations Expense for the three and nine months ended September 30, 2017.

Certain reclassifications have been made to SJI's prior period segments disclosures to conform to the current period presentation. The activities of SJI Midstream, which were presented in the Corporate & Services segment during the three and nine months ended September 30, 2017, are now separated into the Midstream segment for the same periods in 2018. This caused prior period reclassifications to Interest Charges, Income Taxes and Property Additions in Note 6.

Certain reclassifications have been made to SJI's prior period unaudited condensed consolidated balance sheets to conform to the current period presentation. Identifiable Intangible Assets are now recorded in Other Noncurrent Assets as of September 30, 2018, causing a prior period reclassification to the unaudited condensed consolidated balance sheets as of December 31, 2017.

ACQUISITION - On July 1, 2018, SJI, through its wholly-owned subsidiary SJIU, acquired the assets of ETG and ELK from Pivotal Utility Holdings, Inc., a subsidiary of Southern Company Gas (collectively, the "Acquisition"), for total consideration of $1.7 billion (see Note 17). In the second quarter of 2018, SJI completed public equity offerings and issued long-term debt to help fund the Acquisition (see Notes 4 and 14, respectively).

AGREEMENT TO SELL SOLAR ASSETS - On June 27, 2018, the Company, through its wholly-owned subsidiary, Marina, entered into a series of agreements whereby Marina will sell its portfolio of solar energy assets (the “Transaction”) to a third-party buyer. As part of the Transaction, Marina has agreed to sell its distributed solar energy projects located at 143 sites across New Jersey, Maryland, Massachusetts and Vermont with total capacity of approximately 204 MW and a net book value as of June 30, 2018 of $428.9 million (the “Projects”). Total consideration for the Transaction is approximately $347.9 million in cash. As part of the Transaction, Marina will sell the assets comprising the Projects or, in some cases, 100% of the equity interests of certain special purpose companies wholly-owned by Marina that own the assets comprising certain Projects, including MCS, NBS and SBS. The sale of individual Projects will occur on a rolling basis as the conditions precedent to each closing are satisfied, including obtaining certain regulatory filings and receipt of consents to assignment of project contracts and permits. Depending on the timing of closing with respect to individual Projects, the individual purchase prices for those Projects may be adjusted to account for Project revenues retained by Marina during the period prior to such closings, with a maximum aggregate downward adjustment of approximately $5.4 million. Also in connection with the Transaction, Marina will lease certain of the Projects that have not yet passed the fifth anniversary of their placed-in-service dates for U.S. federal income tax purposes back from the buyer from the date each such project is acquired by the buyer until the later of the first anniversary of the applicable acquisition date and the fifth anniversary of the applicable placed-in-service date of the project. The Company currently expects that all but one of the Projects will satisfy all closing conditions on or before December 31, 2018; the remaining Project is expected to satisfy all closing conditions on or before August 31, 2019.

In July 2018, as part of the agreement to sell solar assets, Marina received a cash payment of $62.5 million for the sale of certain solar renewable energy credits ("SRECs").

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The Company has recorded all of the assets related to these projects as Assets Held For Sale on the unaudited condensed consolidated balance sheet as of September 30, 2018, where they will remain until closing conditions have been met and the assets are transferred to the buyer. In October 2018, SJI closed on the sale of certain Projects, including MCS, NBS and SBS (see Note 18).

IMPAIRMENT OF LONG-LIVED ASSETS - Long-lived assets that are held and used are reviewed for impairment whenever events or changes in circumstances indicate carrying values may not be recoverable. Such reviews are performed in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification (ASC) Topic 360 (ASC 360). An impairment loss is indicated if the total future estimated undiscounted cash flows expected from an asset are less than its carrying value. An impairment charge is measured by the difference between an asset's carrying amount and fair value with the difference recorded within Operating Expenses on the condensed consolidated statements of income. Fair values can be determined by a variety of valuation methods, including third-party appraisals, sales prices of similar assets, and present value techniques.

The Transaction described above under "Agreement to Sell Solar Assets" triggered an indicator of impairment in the second quarter 2018 as the purchase price was less than the carrying amount for several of the assets being sold (but not all of them) and, as a result, several assets were considered to be impaired. The Company measured the impairment loss as the difference between the carrying amount of the respective assets and the fair value, which was determined using the purchase price and the expected cash flows from the assets, including potential price reductions resulting from the timing needed to satisfy all required closing conditions. As a result, the Company recorded an impairment charge within the on-site energy production segment of $99.2 million (pre-tax) in Impairment Charges on the unaudited condensed consolidated statements of income during the nine months ended September 30, 2018, to reduce the carrying amount of several assets to their fair market value. The Company estimated the purchase price with the expectation that all but one of the Projects will satisfy all closing conditions on or before December 31, 2018; the remaining Project is expected to satisfy all closing conditions on or before August 31, 2019.

No impairment charges were identified at SJI for the three months ended September 30, 2018. SJI recorded impairment charges of $43.9 million and $44.2 million for the three and nine months ended September 30, 2017, respectively, primarily due to a decline in the market prices of Maryland SRECs, combined with an increase of operating expenses at the on-site energy production segment. No impairments were identified at SJG for the three and nine months ended September 30, 2018 or 2017, respectively.

GAS EXPLORATION AND DEVELOPMENT - SJI capitalizes all costs associated with gas property acquisition, exploration and development activities under the full cost method of accounting. Capitalized costs include costs related to unproved properties, which are not amortized until proved reserves are found or it is determined that the unproved properties are impaired. All costs related to unproved properties are reviewed quarterly to determine if impairment has occurred. No impairment charges were recorded on these properties during the three and nine months ended September 30, 2018 or 2017. As of September 30, 2018 and December 31, 2017, $8.6 million and $8.7 million, respectively, related to interests in unproved properties in Pennsylvania, net of amortization, is included with Nonutility Property and Equipment and Other Noncurrent Assets on SJI's condensed consolidated balance sheets.

TREASURY STOCK - SJI uses the par value method of accounting for treasury stock. As of September 30, 2018 and December 31, 2017, SJI held 229,222 and 216,642 shares of treasury stock, respectively. These shares are related to deferred compensation arrangements where the amounts earned are held in the stock of SJI.

ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC) - SJI and SJG record AFUDC, which represents the estimated debt and equity costs of capital funds that are necessary to finance the construction of new regulated facilities. While cash is not realized currently, AFUDC increases the regulated revenue requirement and is included in rate base and recovered over the service life of the asset through a higher rate base and higher depreciation.

INCOME TAXES - Deferred income taxes are provided for all significant temporary differences between the book and taxable bases of assets and liabilities in accordance with ASC 740 - “Income Taxes.” A valuation allowance is established when it is determined that it is more likely than not that a deferred tax asset will not be realized.

On December 22, 2017, the Tax Cuts and Jobs Act ("Tax Reform") was enacted into law, changing various corporate income tax provisions within the Internal Revenue Code. The law became effective January 1, 2018 but was required to be accounted for in the period of enactment, as such SJI adopted the new requirements in the fourth quarter of 2017. SJI and SJG were impacted in several ways as a result of Tax Reform, including provisions related to the permanent reduction in the U.S. federal corporate income tax rate from 35% to 21%, modification of bonus depreciation and changes to the deductibility of certain business-related expenses.

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The SEC staff issued Staff Accounting Bulletin 118 (SAB 118), which provides guidance on accounting for the tax effects of Tax Reform. SAB 118 provides a measurement period that should not extend beyond one year from the enactment date of Tax Reform for companies to complete the accounting under ASC 740. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of Tax Reform for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of Tax Reform is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of Tax Reform.

SJI and SJG were able to make reasonable, good faith estimates of certain effects and, therefore, recorded provisional adjustments for the following: the tax rules regarding the appropriate bonus deprecation rate that should be applied to assets placed in service after September 27, 2017, including the information required to compute the applicable depreciable tax basis. Further, Tax Reform is unclear in certain respects and will require interpretations and implementing regulations by the Internal Revenue Service, as well as state tax authorities. Tax Reform could also be subject to potential amendments and technical corrections which could impact the Company's financial statements.

Any required changes to the provisional estimates would result in the recording of regulatory assets or liabilities to the extent such amounts are probable of settlement or recovery through customer rates and a net change to income tax expense for any other amounts. Final adjustments to the provisional amounts are expected to be recorded by the fourth quarter of 2018. The accounting for all other applicable provisions of Tax Reform is considered complete based on the current interpretation.

BUSINESS COMBINATION - The Company applies the acquisition method to account for business combinations. The consideration transferred for an acquisition is the fair value of the assets transferred, the liabilities incurred by the acquirer and the equity interests issued by the acquirer. Acquisition related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the consideration transferred over the fair value of the identifiable net assets acquired is recorded as goodwill (see Note 17).

GOODWILL - Goodwill represents future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is initially measured at cost, being the excess of the aggregate of the consideration paid or transferred over the fair value of identifiable net assets acquired. Goodwill is not amortized, but instead is subject to impairment testing on an annual basis, and between annual tests whenever events or changes in circumstances indicate that the fair value of a reporting unit may be below its carrying amount. No such events have occurred during the three and nine months ended September 30, 2018. Goodwill on the unaudited condensed consolidated balance sheets of SJI consisted of $759.8 million as of September 30, 2018 as compared to $3.6 million as of December 31, 2017. The increase of $756.2 million was due to consideration transferred in excess of the fair value of the identifiable net assets acquired as a result of the Acquisition (see Note 17). There is no goodwill on the unaudited condensed balance sheets of SJG.

ASSET MANAGEMENT AGREEMENT (AMA) - On July 1, 2018, SJRG purchased from a third party an AMA whereby SJRG will manage the pipeline capacity of ETG. Total cash payment was $11.4 million. The AMA expires on March 31, 2022. Under the AMA, SJRG will pay ETG an annual fee of $4.25 million, plus additional profit sharing as defined in the AMA. The amounts received by ETG will be credited to its Basic Gas Supply Service (BGSS) clause and returned to its ratepayers. The total purchase price was allocated as follows (in thousands):

Natural Gas in Storage	$9,685
Intangible Asset	19,200

Profit Sharing - Other Liabilities	(17,546)
Total Consideration	$11,339

As of September 30, 2018 the balance of the intangible asset is $17.9 million and is recorded to Other Assets on the unaudited condensed consolidated balance sheets of SJI, with the reduction being due to amortization. As of September 30, 2018, the balance in the liability is $18.2 million and is recorded to Regulatory Liabilities on the unaudited condensed consolidated balance sheets of SJI as of September 30, 2018, with the change resulting from profit sharing earned during the third quarter.

NEW ACCOUNTING PRONOUNCEMENTS - Other than as described below, no new accounting pronouncements issued or effective during 2018 or 2017 had, or are expected to have, a material impact on the condensed consolidated financial statements of SJI, or the condensed financial statements of SJG.

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In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (ASC Topic 606). This ASU supersedes the revenue recognition requirements in FASB ASC 605, Revenue Recognition, and most industry-specific topics. The core principle under this new standard is for an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount reflecting the consideration to which the entity expects to be entitled in exchange for such goods or services, with a five-step model for recognizing and measuring revenue from contracts with customers. The new standard also requires enhanced disclosure regarding the nature, amount, timing and uncertainty of revenues and the related cash flows arising from contracts with customers. In connection with this new standard, the FASB has issued several amendments to ASU 2014-09, as follows:

- In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net). This standard improves the implementation guidance on principal versus agent considerations and whether an entity reports revenue on a gross or net basis.

- In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing. This standard clarifies identifying performance obligations and the licensing implementation guidance.

- In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. This standard provides additional guidance on (a) the objective of the collectibility criterion, (b) the presentation of sales tax collected from customers, (c) the measurement date of non-cash consideration received, (d) practical expedients in respect of contract modifications and completed contracts at transition, and (e) disclosure of the effects of the accounting change in the period of adoption.

- In December 2016, the FASB issued ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers, which amends certain narrow aspects of the guidance, including the disclosure of remaining performance obligations and prior-period performance obligations, as well as other amendments to the guidance on loan guarantee fees, contract costs, refund liabilities, advertising costs and the clarification of certain examples.

The new guidance in ASU 2014-09, as well as all amendments discussed above, was effective for fiscal years, and interim periods within those years, beginning after December 15, 2017.

On January 1, 2018, SJI and SJG adopted ASU 2014-09 and all amendments, in accordance with the guidance in ASC 606. SJI and SJG adopted the new guidance using the modified retrospective method applied to those contracts that were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with the historic accounting under ASC 605. See Note 16. The methods of recognizing revenue for SJI's and SJG's contracts with customers is the same under ASC 605 and ASC 606, as revenues from contracts that SJI and SJG have with customers are currently recorded as gas or electricity is delivered to the customer, which is consistent with the new guidance under ASC 606. As such, there was no significant impact to revenues for the three and nine months ended September 30, 2018 for SJI or SJG as a result of applying ASC 606, and there was no cumulative catch-up to retained earnings for SJI or SJG under the modified retrospective method for changes in accounting for revenues. Further, there were no significant changes to SJI's or SJG's business processes, systems or internal controls over financial reporting needed to support recognition and disclosure under the new guidance. Some revenue arrangements, such as alternative revenue programs and derivative contracts, are excluded from the scope of ASC 606 and, therefore, will be presented separately from revenues under ASC 606 on SJI and SJG's footnote disclosures (see Note 16).

In March 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires lessees to recognize substantially all leases on their balance sheet as a right-of-use asset and corresponding lease liability, including leases currently accounted for as operating leases. The new standard also will result in enhanced quantitative and qualitative disclosures, including significant judgments made by management, to provide greater insight into the extent of revenue and expense recognized and expected to be recognized from existing leases. The accounting for leases by the lessor remains relatively the same. In connection with this new standard, the FASB has issued the following amendments to ASU 2016-02:

- In January 2018, the FASB issued an amendment to clarify the application of the new lease guidance to land easements and provided relief concerning adoption efforts for existing land easements that are not accounted for as leases under current GAAP.

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- In July 2018, the FASB issued ASU 2018-10 and 2018-11, which included a number of technical corrections and improvements to this standard, including an additional option for transition. The guidance initially required a modified retrospective transition method of adoption, under which lessees and lessors were to recognize and measure leases at the beginning of the earliest period presented. The additional, optional transition method allows an entity to initially apply the requirements of the lease standard at the adoption date, and avoid restating the comparative periods.

The new guidance in ASU 2016-02, as well as all amendments discussed above, is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018.

Management has formed an implementation team that has completed the process of inventorying all current contracts, including those of newly acquired ETG and ELK, and has determined the population of leases that will be in scope under the new guidance. Management is currently evaluating the impact that adoption of the guidance on these identified leases will have on SJI's and SJG's financial statements.SJI and SJG plan to elect the optional transition method. The Company does not plan to early adopt the new guidance.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The update simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit’s goodwill with the carrying amount. The amendments in this update are effective for annual and any interim impairment tests performed in periods beginning after December 31, 2019. Management is currently determining the impact that adoption of this guidance will have on the financial statements of SJI and SJG.

In March 2017, the FASB issued ASU 2017-07, Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This ASU is designed to improve guidance related to the presentation of defined benefit costs in the income statement. In particular, this ASU requires an employer to report the service cost component in the same line item(s) as other compensation costs and requires the other components of net periodic pension and postretirement benefit costs to be separately presented in the unaudited condensed consolidated statements of income outside of operating income. The standard was effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Adoption of this guidance was applied retrospectively and did not have a material impact on the financial statements of SJI or SJG; however, current and prior period presentation on the condensed consolidated statements of income were modified for SJI and SJG to conform to this guidance, as described under “Basis of Presentation” above.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This ASU is intended to improve the financial reporting of hedging relationships so that it represents a more faithful portrayal of an entity’s risk management activities (i.e. to help financial statement users understand an entity’s risk exposures and the manner in which hedging strategies are used to manage them), as well as to further simplify the application of the hedge accounting guidance in GAAP. The standard is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods. Management is currently determining the impact that adoption of this guidance will have on the financial statements of SJI and SJG.

In February 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income. This ASU allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from Tax Reform. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Reform and will improve the usefulness of information reported to financial statement users. The standard is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Management is currently determining the impact that adoption of this guidance will have on the financial statements of SJI and SJG.

In March 2018, the FASB issued ASU 2018-04, Investments—Debt Securities (Topic 320) and Regulated Operations (Topic 980): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273 (SEC Update). This ASU incorporates recent SEC guidance which was issued in order to make the relevant interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulation. ASU No. 2018-04 was effective upon issuance. Adoption of this guidance did not have an impact on the financial statement results of SJI or SJG.

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In June 2018, the FASB issued ASU 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. This ASU aligns the accounting for share-based payment awards issued to employees and nonemployees. Under the new guidance, equity-classified share-based payment awards issued to nonemployees will now be measured on the grant date, instead of the previous requirement to remeasure the awards through the performance completion date. For performance conditions, compensation cost associated with the award will be recognized when achievement of the performance condition is probable, rather than upon achievement of the performance condition. The current requirement to reassess the classification (equity or liability) for nonemployee awards upon vesting will be eliminated, except for awards in the form of convertible instruments. The standard is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Management is currently determining the impact that adoption of this guidance will have on the financial statements of SJI and SJG.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. This ASU modifies the disclosure requirements on the timing of liquidation of an investee's assets and the description of measurement uncertainty at the reporting date. Entities are now required to disclose: (1) the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements; and (2) the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. Further, the standard eliminates disclosure requirements with respect to: (1) the transfers between Level 1 and Level 2 of the fair value hierarchy; (2) the policy for timing of transfers between levels; and (3) the valuation process for Level 3 fair value measurements. The standard is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The new disclosure requirement for unrealized gains and losses, the range and weighted average of significant unobservable inputs and the narrative description of measurement uncertainty should be applied prospectively. All other amendments should be applied retrospectively to all periods presented upon their effective date. Management is currently determining the impact that adoption of this guidance will have on the financial statements of SJI and SJG.

In August 2018, the FASB issued ASU 2018-14, Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20) Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plan. This ASU eliminates requirements for certain disclosures such as the amount and timing of plan assets expected to be returned to the employer and the amount of future annual benefits covered by insurance contracts. The standard added new disclosures such as for sponsors of the defined benefit plans to provide information relating to the weighted-average interest crediting rate for cash balance plans and other plans with promised interest crediting rates and an explanation for significant gains or losses related to changes in the benefit obligations for the period. The standard is effective for fiscal years ending after December 15, 2020. Early adoption is permitted. Management is currently determining the impact that adoption of this guidance will have on the financial statements of SJI and SJG.

In August 2018, the FASB issued ASU 2018-15, Intangibles, Goodwill and Other Internal-Use Software (Topic 350): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract. This ASU aligns the requirements for capitalizing implementation costs for hosting arrangements (services) with costs for internal-use software (assets). As a result, certain implementation costs incurred in hosting arrangements will be deferred and amortized. This standard is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. SJI and SJG early adopted this ASU during the third quarter 2018, which resulted in capitalizing implementation costs for hosting arrangements per the new guidance. This did not represent a change to current practices, or to the financial statements of SJI and SJG.

2. STOCK-BASED COMPENSATION PLAN:

On April 30, 2015, the shareholders of SJI approved the adoption of SJI's 2015 Omnibus Equity Compensation Plan (Plan), replacing the Amended and Restated 1997 Stock-Based Compensation Plan that had terminated on January 26,

2015. Under the Plan, shares may be issued to SJI's officers (Officers), non-employee directors (Directors) and other key employees. No options were granted or outstanding during the nine months ended September 30, 2018 and 2017. No stock appreciation rights have been issued under the plans. During the nine months ended September 30, 2018 and 2017, SJI granted 201,858 and 167,734 restricted shares, respectively, to Officers and other key employees under the Plan. Performance-based restricted shares vest over a three-year period and are subject to SJI achieving certain market and earnings-based performance targets, which can cause the actual amount of shares that ultimately vest to range from 0% to 200% of the original shares granted.

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SJI grants time-based shares of restricted stock, one-third of which vest annually over a three-year period and which are limited to a 100% payout. Vesting of time-based grants is contingent upon SJI achieving a return on equity (ROE) of at least 7% during the initial year of the grant and meeting the service requirement. Provided that the 7% ROE requirement is met in the initial year, payout is solely contingent upon the service requirement being met in years two and three of the grant. Beginning in 2018, the vesting and payout of time-based shares of restricted stock is only contingent upon the service requirement being met in years one, two, and three of the grant. During the nine months ended September 30, 2018 and 2017, Officers and other key employees were granted 67,479 and 53,058 shares of time-based restricted stock, respectively, which are included in the shares noted above.

Grants containing market-based performance targets use SJI's total shareholder return (TSR) relative to a peer group to measure performance. As TSR-based grants are contingent upon market and service conditions, SJI is required to measure and recognize stock-based compensation expense based on the fair value at the date of grant on a straight-line basis over the requisite three-year period of each award. In addition, SJI identifies specific forfeitures of share-based awards, and compensation expense is adjusted accordingly over the requisite service period. Compensation expense is not adjusted based on the actual achievement of performance goals. The fair value of TSR-based restricted stock awards on the date of grant is estimated using a Monte Carlo simulation model.

Earnings-based performance targets include pre-defined EGR and ROE goals to measure performance. Beginning in 2016, performance targets include pre-defined compounded earnings annual growth rate (CEGR) for SJI. As EGR-based, ROE-based and CEGR-based grants are contingent upon performance and service conditions, SJI is required to measure and recognize stock-based compensation expense based on the fair value at the date of grant over the requisite three-year period of each award. The fair value is measured as the market price at the date of grant. The initial accruals of compensation expense are based on the estimated number of shares expected to vest, assuming the requisite service is rendered and probable outcome of the performance condition is achieved. That estimate is revised if subsequent information indicates that the actual number of shares is likely to differ from previous estimates. Compensation expense is ultimately adjusted based on the actual achievement of service and performance targets.

During the nine months ended September 30, 2018 and 2017, SJI granted 26,416 and 30,394 restricted shares, respectively, to Directors. Shares issued to Directors vest over twelve months and contain no performance conditions. As a result, 100% of the shares granted generally vest.

The following table summarizes the nonvested restricted stock awards outstanding for SJI at September 30, 2018 and the assumptions used to estimate the fair value of the awards:

	Grants	Shares Outstanding	Fair Value Per Share	Expected Volatility	Risk-Free Interest Rate
Officers & Key Employees -	2016 - TSR	51,587	$22.53	18.1 %	1.31 %
	2016 - CEGR, Time	65,104	$23.52	N/A	N/A
	2017 - TSR	44,376	$32.17	20.8 %	1.47 %
	2017 - CEGR, Time	72,992	$33.69	N/A	N/A
	2018 - TSR	61,009	$31.05	21.9 %	2.00 %
	2018 - CEGR, Time	124,072	$31.23	N/A	N/A
Directors -	2018	26,416	$31.16	N/A	N/A

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

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The following table summarizes the total stock-based compensation cost to SJI for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Officers & Key Employees	$549	$1,087	$2,739	$3,274
Directors	206	256	617	767
Total Cost	755	1,343	3,356	4,041
Capitalized	(101)	(96)	(303)	(288)
Net Expense	$654	$1,247	$3,053	$3,753

As of September 30, 2018, there was $6.3 million of total unrecognized compensation cost related to nonvested stock-based compensation awards granted under the plans. That cost is expected to be recognized over a weighted average period of 1.9 years.

The following table summarizes information regarding restricted stock award activity for SJI during the nine months ended September 30, 2018, excluding accrued dividend equivalents:

	Officers and Other Key Employees	Directors	Weighted Average Fair Value
Nonvested Shares Outstanding, January 1, 2018	342,793	30,394	$ 28.60
Granted	201,858	26,416	$ 31.17
Cancelled/Forfeited	(80,610)	—	$ 28.72
Vested	(44,901)	(30,394)	$ 30.56
Nonvested Shares Outstanding, September 30, 2018	419,140	26,416	$ 29.56

During the nine months ended September 30, 2018 and