STANDEX INTERNATIONAL CORP/DE/
Form 10-K
August 31, 2009

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

FORM 10-K

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

For the fiscal year ended June 30, 2009 Commission File Number 1-7233

STANDEX INTERNATIONAL CORPORATION
(Exact name of registrant as specified in its Charter)

DELAWARE	31-0596149
(State of incorporation)	*(I.R.S. Employer Identification No.)*
6 MANOR PARKWAY, SALEM, NEW HAMPSHIRE	03079
(Address of principal executive offices)	*(Zip Code)*

(603) 893-9701
(Registrant s telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE

SECURITIES EXCHANGE ACT OF 1934:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, Par Value $1.50 Per Share	New York Stock Exchange

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES [ ] **NO** [X]

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

YES [ ] **NO** [X]

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

Indicate by check mark 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). **YES** [ ] **NO** [ ]

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

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer __ Accelerated filer X Non-accelerated filer __ Smaller Reporting Company __

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES [ ] **NO** [X]

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant at the close of business on December 31, 2008 was approximately $244,000,000. Registrant s closing price as reported on the New York Stock Exchange for December 31, 2008 was $19.84 per share.

The number of shares of Registrant's Common Stock outstanding on August 24, 2009 was 12,307,386.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Registrant s 2009 Annual Meeting of Stockholders (the Proxy Statement) (Part III) of this report are incorporated by reference.

Forward Looking Statement

Statements contained in this Annual Report on Form 10-K that are not based on historical facts are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of forward-looking terminology such as should, could, "may," will, expect," "believe "estimate," "anticipate," intends, "continue," or similar terms or variations of those terms or the negative of those terms. There are many factors that affect the Company s business and the results of its operations and may cause the actual results of operations in future periods to differ materially from those currently expected or desired. These factors include, but are not limited to conditions in the financial and banking markets general and international recessionary economic conditions, including the impact, length and degree of the current recessionary conditions on the customers and markets we serve and more specifically conditions in the automotive, aerospace, energy, housing and general transportation markets, lower-cost competition, the relative mix of products which impact margins and operating efficiencies, both domestic and foreign, in certain of our businesses, the impact of higher raw material and component costs, particularly steel, petroleum based products and refrigeration components, an inability to realize the expected cost savings from effective completion of plant consolidations, cost reduction efforts, productivity enhancements and the implementation of lean enterprise manufacturing techniques, the inability to achieve the savings expected from the sourcing of raw materials from and diversification efforts in emerging markets and the inability to achieve synergies contemplated by the Company. In addition, any forward-looking statements represent management's estimates only as of the day made and should not be relied upon as representing management's estimates as of any subsequent date. While the Company may elect to update forward-looking statements at some point in the future, the Company and management specifically disclaim any obligation to do so, even if management's estimates change.

PART I

Item 1. Business

Standex International Corporation (the "Company" or "we" (1)) was incorporated in 1975 and is the successor of a corporation organized in 1955. We have paid dividends each quarter since Standex became a public corporation in November 1964.

We are a leading manufacturer of a variety of products and services for diverse industrial market segments. We have 12 operating segments, aggregated and organized for reporting purposes into five segments: Food Service Equipment Group, Air Distribution Products Group (ADP), Engraving Group, Engineering Technologies Group and Electronics and Hydraulics Group. Overall management, strategic development and financial control are maintained by the executive staff from our corporate headquarters located in Salem, New Hampshire.

Our corporate strategy has several primary components.

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It is our direction to grow larger and more profitable business units through both organic initiatives and acquisitions. On an ongoing basis we identify and implement organic growth initiatives such as new product development, geographic expansion, introduction of products and technologies into new markets and applications and leveraging of sales synergies between business units, key accounts and strategic sales channel partners. Also, we utilize strategically aligned or bolt on acquisitions to create both sales and cost synergies with our core business platforms to accelerate their growth and margin improvement. There is a particular focus on identifying and investing in opportunities to increase the global presence and capabilities of our businesses. From time to time we have divested businesses that we felt were not strategic or did not meet our growth and return expectations.

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Our focus is on the growth and development of businesses that provide customer solutions or engineered products that provide higher levels of value add to our customers. These types of businesses generally demonstrate the ability to sustain sales and profit growth over time and provide superior operating margins to enhance shareholder returns.

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We have a focus on operational excellence through the continuous improvement in the cost structure of our businesses and in management of working capital. We recognize that our businesses are competing in a global economy that requires that we constantly strive to improve our competitive position. We have deployed a number of management competencies including lean enterprise, the use of low cost manufacturing facilities in countries such as Mexico and China, the consolidation of manufacturing facilities to achieve economies of scale and leveraging of fixed infrastructure costs, alternate sourcing to achieve procurement cost reductions, and shop floor productivity improvement initiatives to constantly drive improvements in the cost structure of our business units. Further, we have made a priority of improving the utilization and efficiency in the investment of working capital in our business units.

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Finally, we have a constant focus on cash flow generation. We recognize that cash flow is fundamental in our ability to invest in organic and acquisitive growth for our business units, to allow us to return cash to our shareholders in the form of dividends and that it is a measure of the quality of the earnings that we generate over time.

(1)

References in this Annual Report on Form 10-K to "Standex" or the "Company" or we, our or us shall mean Standex International Corporation and its subsidiaries.

(2)

Unless otherwise noted, references to years are to fiscal years.

Please visit our web site at www.standex.com to learn more about us or to review our most recent SEC filings. The information on our web site is for informational purposes only and is not incorporated into this Annual Report on Form 10-K.

Description of Segments

Food Service Equipment Group

Our Food Service Equipment businesses are leading, broad-line manufacturers of commercial food service equipment which includes products on the cold or in the refrigerated segment of food service applications and on the hot in the cooking segment of the market. Our products are used throughout the entire food service process; from storage, to preparation, to cooking and to display. The equipment that we design and manufacture is utilized in restaurants, convenience stores, quick-service restaurants, supermarkets, drug stores and institutions such as hotels, casinos and corporate and school cafeterias to meet the challenges of providing food and beverages that are fresh and appealing with the comfort of knowing the food safety and reliability of the equipment. The Food Service Equipment Group also applies technology and product expertise in the health science and medical markets. Customers in this segment include laboratories, health care institutions, and blood banks. Our products are sold direct, through dealer buying groups and through industry representatives. Through innovation and acquisition, we continue to expand this segment. Our brands and products include:

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Master-Bilt® refrigerated cabinets, cases, display units, and walk-in coolers and freezers

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Nor-Lake, Incorporated and Kool Star refrigerated walk-in coolers, freezers, refrigeration systems and cases to meet food service and scientific needs

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APW Wyott, American Permanent Ware, Bakers Pride and BevLes commercial ovens, griddles, char broilers and toasters used in cooking, toasting, warming and merchandising food

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American Foodservice custom-fabricated food service counters, buffet tables and cabinets

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Barbecue King® and BKI® commercial cook and hold units, rotisseries, pressure fryers, ovens and baking equipment

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Federal Industries merchandizing display cases

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Procon® rotary vane pumps used in beverage and industrial fluid handling applications

Air Distribution Products Group

Our Air Distribution Products (ADP) business is a leading manufacturer of metal duct and fittings for residential heating, ventilating and air conditioning applications. With manufacturing locations throughout the United States, ADP s ability to service national accounts seamlessly gives ADP a competitive advantage over its smaller regional competitors. Our total procurement leverage on the purchase of galvanized steel used in the production of our products and the investment in technology allows ADP to produce high-volume output at a lower cost while providing superior customer service. Our products are sold through both HVAC wholesalers and through large scale do-it-yourself stores throughout the continental United States. Our brand names in Air Distribution Products include Snappy®, ACME, ALCO and Standex.

Engraving Group

Our Engraving Group is a world leader in texturizing molds used in the production of plastic components, giving the final product the cosmetic appearance and appeal that our consumers require. We provide texturizing services for

molds used to produce plastic components used in automotive applications and consumer products including toys, computers and other electronics devices. Our worldwide locations enable us to better serve our customers within key geographic areas, including the United States, Canada, Europe, China, Southeast Asia, Australia and South America. In addition to mold texturizing, the Engraving Group also produces embossed and engraved rolls and plates and process tooling and machinery serving a wide variety of industries. Through the development of new digital based process technology and acquisitions, the Engraving Group continues to build its market leadership position and to expand the breadth of products and services it provides to its customers. The companies and products within the Engraving Group include Roehlen®, I R International and Eastern Engraving which engrave and emboss rolls and plates used in manufacturing continuous length materials; Innovent which makes specialized tooling used to manufacture absorbent cores of many consumer and medical products; Mold-Tech® which texturizes molds used in manufacturing plastic injected components; Mullen® Burst Testers; and Perkins converting and finishing machinery. Our products are sold direct and through manufacturers representatives. The Engraving Group serves a number of industries including the automotive, plastics, building products, synthetic materials, converting, textile and paper industry, computer, houseware and construction industries.

Engineering Technologies Group

Our Engineering Technologies Group, consisting of our Spincraft® operating segment (formerly reported as part of the Engineered Products Group), provides customized solutions in the fabrication and machining of engineered components. Sales are made directly to our customers in the aerospace, energy, defense, marine, and aviation markets.

Electronics and Hydraulics Group

Our Electronics and Hydraulics Group consists of operating segments not otherwise aggregated under segment reporting criteria. The following describes the businesses and products of our Electronics and Hydraulics Group.

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Custom Hoists (formerly reported as the Hydraulic Products Group) which provides single and double acting telescopic and piston rod hydraulic cylinders to manufacturers of dump truck and dump trailers and other material handling applications. Sales are made directly to OEMs manufacturing dump trucks, trash collection vehicles, lift trucks and other mobile units requiring hydraulic power.

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Standex Electronics (formerly reported as part of the Engineered Products Group), which manufactures reed switches, electrical connectors, sensors, toroids and relays, fixed and variable inductors and electronic assemblies, fluid sensors, tunable inductors, transformers and magnetic components. Sales are made both directly to customers and through

manufacturers representatives, dealers and distributors. End user market segments include automotive, white goods, lighting, HVAC, aerospace, military, medical, security, and general industrial applications.

Raw Materials

Raw materials and components necessary for the manufacture of our products are generally available from numerous sources. Generally, we are not dependent on a single source of raw materials and supplies. We do not foresee unavailability of materials or supplies which would have a significant adverse effect on any of our businesses, nor any of our segments, in the near term. The prices of many commodities that we use generally remain at higher levels than in past years. Discussion of the impacts of these materials is included in Management s Discussion and Analysis.

Seasonality

We are a diversified business with generally low levels of seasonality, however our fiscal third quarter is typically the period with the lowest level of sales volume.

Patents and Trademarks

We hold approximately 84 United States patents covering processes, methods and devices and approximately 56 United States trademarks. Many counterparts of these patents have also been registered in various foreign countries. In addition, we have various foreign registered and common law trademarks.

While we believe that many of our patents are important, we credit our competitive position in our niche markets to engineering capabilities, manufacturing techniques and skills, marketing and sales promotions, service and the delivery of quality products.

Due to the diversity of our businesses and the markets served, the loss of any single patent or trademark would not, in our opinion, materially affect any individual segment.

Customers

Our business is not dependent upon a single customer or very few customers, the loss of any one of which would have a material adverse effect on our operations. No customer accounted for more than 5% of our consolidated revenue in fiscal 2009 or any of the years presented.

Working Capital

Our primary source of working capital is the cash generated from continuing operations. No segments require any special working capital needs outside of the normal course of business.

Backlog

Backlog orders believed to be firm at June 30, 2009 and 2008 are as follows (in thousands):

	2009	**2008**
Food Service Equipment	$37,523	$42,368
Air Distribution Products	726	2,492
Engraving	11,543	10,410
Engineering Technologies	65,261	53,255
Electronics and Hydraulics	9,290	18,701
Total	124,343	127,226
Net realizable beyond one year	28,008	15,563
Net realizable within one year	$96,335	$111,663

Competition

Standex manufactures and markets products many of which have achieved a unique or leadership position in their market. However, we encounter competition in varying degrees in all product groups and for each product line. Competitors include domestic and foreign producers of the same and similar products. The principal methods of competition are price, delivery schedule, quality of services, other terms and conditions of sale and product performance.

U. S. Domestic Housing Market

Our ADP segment is dependent upon demand in the new residential housing construction market. This market is in the midst of a cyclical downtown with demand at its lowest point in over 50 years. Discussion of the impact of this downturn on this segment is included in Management s Discussion and Analysis.

International Operations

Substantially all of our international operations are included in the Food Service Equipment, Engraving Group, and Electronics and Hydraulics Products business segments. International operations are conducted at 31 locations, in Europe, Canada, China, Singapore, Australia, Mexico and Brazil. See the Notes to Consolidated Financial Statements for international operations financial data. Our international operations contributed approximately 13% of operating revenues in 2009 and 14% in 2008. International operations are subject to certain inherent risks in connection with the conduct of business in foreign countries including, exchange controls, price controls, limitations on participation in local enterprises, nationalizations, expropriation and other governmental action and changes in currency exchange rates.

Research and Development

Developing new and improved products, broadening the application of established products, and continuing efforts to improve and develop new methods, processes and equipment, have driven our success. However, due to the nature of our manufacturing operations and the types of products manufactured, expenditures for research and development are not significant to any individual segment or in the aggregate. Research and development costs are quantified in the Notes to Consolidated Financial Statements. We develop and design new products to meet customer needs or in order to offer enhanced products or to provide customized solutions for customers.

Environmental Matters

During 2008, the Company entered into an Administrative Order of Consent with the U.S. Environmental Protection Agency related to the removal of various PCB-contaminated materials and soils at a site where the Company leased a building and conducted operations from 1967-1979. See the notes to our consolidated financial statements for further information regarding this event.

To the best of our knowledge, we believe that we are presently in substantial compliance with all existing applicable environmental laws and regulations and do not anticipate any instances of non-compliance that will have a material effect on our future capital expenditures, earnings or competitive position.

Financial Information about Geographic Areas

Information regarding revenues from external customers attributed to: the United States, all foreign countries and any individual foreign country, if material, is contained in the Notes to Consolidated Financial Statements for Industry Segment Information .

Number of Employees

As of June 30, 2009, we employed approximately 3,300 employees of which approximately 2,300 were in the United States. About 500 of our U.S. employees were represented by unions. Approximately 17% of our workforce is situated in low-cost manufacturing regions such as Mexico and Asia.

Long-Lived Assets

Long-lived assets are described and discussed in the Notes to Consolidated Financial Statements under the caption Long-Lived Assets.

Available Information

Standex s corporate headquarters are at 6 Manor Parkway, Salem, New Hampshire 03079, and our telephone number at that location is (603) 893-9701.

The U. S. Securities and Exchange Commission (the SEC) maintains an internet website at http://www.sec.gov that contains our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statements, and all amendments thereto. All reports that we file with the SEC may be read and copied at the SEC s Public Reference Room at 100 F Street, N.E., Washington, DC 20549. Information about the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. Standex s internet website address is www.standex.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statements, and all amendments thereto, are available free of charge on our website as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. In addition, our code of business conduct, our code of ethics for senior financial management, our corporate governance guidelines, and the charters of

each of the committees of our Board of Directors (which are not deemed filed by this reference), are available on our website and are available in print to any Standex shareholder, without charge, upon request in writing to Chief Legal Officer, Standex International Corporation, 6 Manor Parkway, Salem, New Hampshire, 03079 .

The certifications of Standex s Chief Executive Officer and Chief Financial Officer, as required by the rules adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, are filed as exhibits to this Form 10-K. Standex s Chief Executive Officer, Roger L. Fix, provided an annual certification to the New York Stock Exchange dated November 12, 2008, without qualification, as required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual.

Item 1A. Risk Factors

An investment in the Company s common shares involves various risks, including those mentioned below and those that are discussed from time to time in our other periodic filings with the SEC. Investors should carefully consider these risks, along with the other information filed in this report, before making an investment decision regarding our common shares. There may be additional risks which the Company is currently unaware of or which we currently consider immaterial. All of these risks could have a material adverse effect on our financial condition, results of operations and/or value of our common shares.

A continuation of the deterioration in the economic environment could adversely affect our operating results and financial condition.

Recessionary economic conditions coupled with a tightening of credit could continue to adversely impact major markets served by our businesses, including cyclical markets such as residential housing, automotive, heavy construction vehicle, general industrial and food service. A continuation of the economic recession could adversely affect our business by:

reducing demand for our products and services, particularly in markets where demand for our products and services is cyclical;

causing delays or cancellations of orders for our products or services;

reducing capital spending by our customers;

increasing price competition in our markets;

increasing difficulty in collecting accounts receivable;

increasing the risk of excess or obsolete inventories;

increasing the risk of impairment to long-lived assets due to reduced use of manufacturing facilities;

increasing the risk of supply interruptions that would be disruptive to our manufacturing processes; and

reducing the availability of credit for our customers.

We rely on our credit facility to provide us with sufficient capital to operate our businesses.

We rely on our revolving credit facility to provide us with sufficient capital to operate our businesses. The availability of borrowings under our revolving credit facility is dependent upon our compliance with the covenants set forth in the facility, including the maintenance of certain financial ratios. Our ability to comply with these covenants is dependent upon our future performance, which is subject to economic conditions in our markets along with factors that are beyond our control. Violation of those covenants, whether as a result of recording goodwill impairment charges, incurring operating losses or otherwise, could result in our lenders restricting or terminating our borrowing ability under our credit facility, cause us to be liable for covenant waiver fees or other obligations, or trigger an event of default under the terms of our credit facility which could result in acceleration of the debt under the facility and require prepayment of the debt before its due date. Even if new financing is available in the event of a default under our current credit facility, the interest rate charged on any new borrowing could be substantially higher than under the current credit facility, thus adversely affecting our overall financial condition. If our lenders reduce or terminate our access to amounts under our credit facility, we may not have sufficient capital to fund our working capital needs or we may need to secure additional capital or financing to fund our working capital requirements or to repay outstanding debt under our credit facility.

Our credit facility contains covenants that restrict our activities.

Our revolving credit facility contains covenants that restrict our activities, including our ability to:

incur additional indebtedness;

make investments;

create liens;

pay cash dividends unless we are in compliance with certain financial covenants; and

sell material assets.

Our global operations subject us to international business risks.

We operate in 31 locations outside of the United States in North America, South America, Europe and Asia. If we are unable to successfully manage the risks inherent to the operation and expansion of our global businesses, those risks could have a material adverse effect on our business, results of operations or financial condition. Those international business risks include:

fluctuations in currency exchange rates;

restrictions on repatriation of earnings;

import and export controls;

political, social and economic instability or disruptions;

potential adverse tax consequences;

difficulties in staffing and managing multi-national operations;

difficulties in our ability to enforce legal rights and remedies; and

changes in regulatory requirements.

Failure to achieve expected savings and synergies could adversely impact our operating profits and cash flows.

We focus on reducing operating costs through lean and low cost sourcing and manufacturing initiatives, improving working capital management, developing new and enhanced products, consolidating factories where appropriate, automating manufacturing capabilities, diversification efforts and completing acquisitions which deliver synergies to supplement sales and growth. If we were unable to reduce costs and expenses through such programs, this failure could adversely affect our operating profits and cash flows. In addition, actions we may take to consolidate manufacturing operations to achieve cost savings or adjust to market developments may result in restructuring charges that adversely affect our profits.

We face significant competition in our markets and, if we are not able to respond to competition in our markets, our net sales, profits and cash flows could decline.

Our businesses operate in highly competitive markets. In order to effectively compete, we must retain longstanding relationships with significant customers, offer attractive pricing, develop enhancements to products that offer performance features that are superior to our competitors and which maintain our brand recognition, continue to automate our manufacturing capabilities, continue to grow our business by establishing relationships with new customers, diversify into emerging markets and penetrate new markets. If we are unable to compete effectively, our net sales, profitability and cash flows could decline. Pricing pressures resulting from competition may adversely affect our net sales and profitability.

If we are unable to successfully introduce new products and product enhancements, our future growth could be impaired.

Our ability to develop new products and innovations to satisfy customer needs or demands in the markets we serve can affect our competitive position and often requires significant investment of resources. Difficulties or delays in research, development or production of new products and services or failure to gain market acceptance of new products and technologies may significantly reduce future net sales and adversely affect our competitive position.

Increased prices or significant shortages of the commodities that we use in our businesses could result in lower net sales, profits and cash flows.

We purchase large quantities of steel, refrigeration components, foam insulation and other metal commodities for the manufacture of our products. Historically, prices for these commodities have fluctuated, and we have not entered into long term contracts or other arrangements to hedge the risk of price increases in these commodities. Significant price increases for these commodities could adversely affect our operating profits if we cannot timely mitigate the price increases by successfully sourcing lower cost commodities or by passing the increased costs on to customers. Shortages or other disruptions in the supply of these commodities could delay sales or increase costs.

An inability to identify or complete future acquisitions could adversely affect our future growth.

As part of our growth strategy, we intend to pursue acquisitions that provide opportunities for profitable growth for our businesses and which enable us to leverage our competitive strengths. For example, in 2007, we made two acquisitions in our Food Service Equipment Group which significantly increased the size of that group. While we continue to evaluate potential acquisitions, we may not be able to identify and successfully negotiate suitable acquisitions, obtain financing for future acquisitions on satisfactory terms, obtain regulatory approval for certain acquisitions or otherwise complete acquisitions in the future. An inability to identify or complete future acquisitions could limit our future growth.

We may experience difficulties in integrating acquisitions.

Integration of acquired companies involves a number of risks, including:

inability to operate acquired businesses profitably;

failure to accomplish strategic objectives for those acquisitions;

unanticipated costs relating to acquisitions or to the integration of the acquired businesses;

difficulties in achieving planned cost-savings and synergies; and

possible future impairment charges for goodwill and non-amortizable intangible assets that are recorded as a result of acquisitions.

Additionally, our level of indebtedness may increase in the future if we finance acquisitions with debt, which would cause us to incur additional interest expense and could increase our vulnerability to general adverse economic and industry conditions and limit our ability to service our debt or obtain additional financing. We cannot assure that future acquisitions will not have a material adverse effect on our financial condition, results of operations and cash flows.

Impairment charges could reduce our profitability.

We test goodwill and our other intangible assets with indefinite useful lives for impairment on an annual basis or on an interim basis if an event occurs that might reduce the fair value of the reporting unit below its carrying value. During fiscal 2009, we incurred an impairment charge of $21.3 million relating to goodwill and intangible assets in our Food Service Equipment Group. Various uncertainties, including continued adverse conditions in the capital markets or changes in general economic conditions, could impact the future operating performance at one or more of our businesses which could significantly affect our valuations and could result in additional future impairments. The recognition of an impairment of a significant portion of goodwill would negatively affect our results of operations, the effect of which could be material to us.

Material adverse or unforeseen legal judgments, fines, penalties or settlements could have an adverse impact on our profits and cash flows.

We are and may, from time to time, become a party to legal proceedings incidental to our businesses, including, but not limited to, alleged claims relating to product liability, environmental compliance, patent infringement, commercial disputes and employment matters. In accordance with United States generally accepted accounting principles, we have established reserves based on our assessment of contingencies. Subsequent developments in legal proceedings

may affect our assessment and estimates of loss contingencies recorded as reserves which could require us to record additional reserves or make additional material payments which could adversely affect our profits and cash flows. Even the successful defense of legal proceedings may cause us to incur substantial legal costs and may divert management's time and resources away from our businesses.

The costs of complying with existing or future environmental regulations, and of correcting any violations of these regulations, could increase our expenses and reduce our profitability.

We are subject to a variety of environmental laws relating to the storage, discharge, handling, emission, generation, use and disposal of chemicals, hazardous waste and other toxic and hazardous materials used to manufacture, or resulting from the process of manufacturing, our products. We cannot predict the nature, scope or effect of regulatory requirements to which our operations might be subject or the manner in which existing or future laws will be administered or interpreted. We are also exposed to potential legacy environmental risks relating to businesses we no longer own or operate. Future regulations could be applied to materials, products or activities that have not been subject to regulation previously. The costs of complying with new or more stringent regulations, or with more vigorous enforcement of these or existing regulations, could be significant.

In addition, properly permitted waste disposal facilities used by us as a legal and legitimate repository for hazardous waste may in the future become mismanaged or abandoned without our knowledge or involvement. In such event, legacy landfill liability could attach to or be imposed upon us in proportion to the waste deposited at any disposal facility.

Environmental laws require us to maintain and comply with a number of permits, authorizations and approvals and to maintain and update training programs and safety data regarding materials used in our processes. Violations of these requirements could result in financial penalties and other enforcement actions. We could be required to halt one or more portions of our operations until a violation is cured. Although we attempt to operate in compliance with these environmental laws, we may not succeed in this effort at all times. The costs of curing violations or resolving enforcement actions that might be initiated by government authorities could be substantial.

Contingent liabilities from businesses that we have sold could adversely affect our results of operations and financial condition.

We have retained responsibility for some of the known and unknown contingent liabilities related to a number of businesses we have sold, such as lawsuits, tax liabilities, product liability claims and environmental matters and have agreed to indemnify purchasers of these businesses for certain of those contingent liabilities. The purchaser of Berean filed a Chapter 11 bankruptcy petition on June 9, 2009. On July 27, 2009, the Bankruptcy Court approved a sale under Section 363 of the Bankruptcy Code of substantially all of the assets of Berean to a newly-formed entity, Berean Christian Stores Endeavor, LLC ("Berean Endeavor"), which has assumed all of the Berean leases on which we remain a guarantor. The failure of Berean Endeavor to improve the performance of the business could make it

unable to satisfy its obligations under the leases, which could trigger our continuing guaranty obligation.

The trading price of our common stock has been volatile, and investors in our common stock may experience substantial losses.

The trading price of our common stock has been volatile and may become volatile again in the future. The trading price of our common stock could decline or fluctuate in response to a variety of factors, including:

our failure to meet the performance estimates of securities analysts;

changes in financial estimates of our net sales and operating results or buy/sell recommendations by securities analysts;

fluctuations in our quarterly operating results;

substantial sales of our common stock;

changes in the amount or frequency of our payment of dividends or repurchases of our common stock;

general stock market conditions; or

other economic or external factors.

Decreases in discount rates and actual rates of return could require future pension contributions to our pension plans which could limit our flexibility in managing our company.

Key assumptions inherent in our actuarially calculated pension plan obligations and pension plan expense are the discount rate and the expected rate of return on plan assets. If discount rates and actual rates of return on invested plan assets were to decrease significantly, our pension plan obligations could increase materially. The size of future required pension contributions could require us to dedicate a greater portion of our cash flow from operations to making contributions, which could negatively impact our financial flexibility.

Various restrictions in our charter documents, Delaware law and our credit agreement could prevent or delay a change in control of us that is not supported by our board of directors.

We are subject to a number of provisions in our charter documents, Delaware law and our credit facility that may discourage, delay or prevent a merger, acquisition or change of control that a stockholder may consider favorable. These anti-takeover provisions include:

maintaining a classified board and imposing advance notice procedures for nominations of candidates for election as directors and for stockholder proposals to be considered at stockholders' meetings;

a provision in our certificate of incorporation that requires the approval of the holders of 80% of the outstanding shares of our common sock to adopt any agreement of merger, the sale of substantially all of the assets of Standex to a third party or the issuance or transfer by Standex of voting securities having a fair market value of $1 million or more to a third party, if in any such case such third party is the beneficial owner of 10% or more of the outstanding shares of our common stock, unless the transaction has been approved prior to its consummation by all of our directors;

requiring the affirmative vote of the holders of at least 80% of the outstanding shares of our common stock for stockholders to amend our amended and restated by-laws;

covenants in our credit facility restricting mergers, asset sales and similar transactions; and

the Delaware anti-takeover statute contained in Section 203 of the Delaware General Corporation Law.

Section 203 of the Delaware General Corporation Law prohibits a merger, consolidation, asset sale or other similar business combination between Standex and any stockholder of 15% or more of our voting stock for a period of three years after the stockholder acquires 15% or more of our voting stock, unless (1) the transaction is approved by our board of directors before the stockholder acquires 15% or more of our voting stock, (2) upon completing the

transaction the stockholder owns at least 85% of our voting stock outstanding at the commencement of the transaction, or (3) the transaction is approved by our board of directors and the holders of 66 2/3% of our voting stock, excluding shares of our voting stock owned by the stockholder.

Item 1B. Unresolved Staff Comments

Not applicable

Item 2. Properties

At June 30, 2009, we operated a total of 80 manufacturing plants and warehouses located throughout the United States, Europe, Canada, Australia, Singapore, China, Brazil and Mexico. The Company owned 33 of the facilities and the balance were leased. The approximate building space utilized by each product group of Standex at June 30, 2009 is as follows (in thousands):

	Area in Square Feet	
	Owned	**Leased**
Food Service Equipment	1,298	409
Air Distribution Products	431	245
Engraving	421	227
Engineering Technologies	174	45
Electronics and Hydraulics	152	164
Corporate and other	178	--
Total	2,654	1,090

In general, the buildings are in sound operating condition and are considered to be adequate for their intended purposes and current uses.

We own substantially all of the machinery and equipment utilized in our businesses.

Item 3. Legal Proceedings

There are no material pending legal proceedings.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of stockholders during the fourth quarter of the fiscal year.

Executive Officers of Standex

The executive officers of the Company as of June 30, 2009 were as follows:

Name	Age	Principal Occupation During the Past Five Years
Roger L. Fix	56	Chief Executive Officer of the Company since January 2003; President of the Company since December 2001
Thomas D. DeByle	49	Vice President, Chief Financial Officer, and Treasurer of the Company since March 2008; Vice President of Finance and Chief Financial Officer of Bobcat Company Doosan Infracore November 2007 March 2008 due to the divestiture of the Compact Equipment businesses from Ingersoll Rand, prior thereto various senior financial positions in Ingersoll Rand from September 2001 November 2007 including Sector CFO of the Compact Vehicle Technologies Sector (Club Car and Bobcat).
Deborah A. Rosen	54	Chief Legal Officer of the Company since October 2001; Vice President of the Company since July 1999; Secretary of the Company since 1997.
John Abbott	50	Group Vice President of the Food Service Group since December 2006; and prior thereto President of Filtration Group of Pentair from 2004 to 2006.

The executive officers are elected each year at the first meeting of the Board of Directors subsequent to the annual meeting of stockholders, to serve for one-year terms of office. There are no family relationships among any of the directors or executive officers of the Company.

PART II

Item 5. Market for Standex Common Stock

Related Stockholder Matters and Issuer Purchases of Equity Securities

The principal market in which the Common Stock of Standex is traded is the New York Stock Exchange under the ticker symbol SXI . The high and low sales prices for the Common Stock on the New York Stock Exchange and the dividends paid per Common Share for each quarter in the last two fiscal years are as follows:

Common Stock Prices and Dividends Paid

	Common Stock Price Range				**Dividends Per Share**	
	2009		**2008**			
Year Ended June 30	**High**	**Low**	**High**	**Low**	**2009**	**2008**
First quarter	$30.00	$18.84	$29.23	$20.68	$0.21	$0.21
Second quarter	29.48	17.00	22.54	17.45	0.21	0.21
Third quarter	20.82	7.85	22.75	16.01	0.05	0.21
Fourth quarter	15.04	8.30	23.64	18.20	0.05	0.21

The approximate number of stockholders of record on August 24, 2009 was 2,379.

Additional information regarding our equity compensation plans is presented in the Notes to Consolidated Financial Statements under the caption Stock-Based Compensation and Purchase Plans and Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

On May 8, 2009, the Company issued 42,783 shares of common stock from its treasury shares to the former owners of IR International, which was acquired by Standex in 2003. The shares, along with a cash payment of $3.6 million, were issued upon the receipt of a Certificate of Satisfactory Completion of Remediation from the Virginia Department of Environmental Quality for the Company s Richmond, Virginia, Engraving Group facility, which was a contingent requirement of the acquisition whereby Standex purchased the facility. An exemption from registration of the shares

was claimed under Regulation D, Rule 506 of the Securities Act. The exemption applied because there were fewer than 35 purchasers, each purchaser was an accredited investor and the transaction did not involve a public offering.

Issuer Purchases of Equity Securities (1)

Quarter Ended June 30, 2009

Period	(a) Total Number of Shares (or units) Purchased	(b) Average Price Paid per Share (or unit)	(c) Total Number of Shares (or units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Appropriate Dollar Value) of Shares (or units) that May Yet Be Purchased Under the Plans or Programs
April 1, 2009 - April 30, 2009	151	$10.00	151	686,805
May 1, 2009 - May 31, 2009	98	$9.19	98	686,707
June 1, 2009 - June 30, 2009	130	$10.10	130	686,577
TOTAL	379	$9.82	379	686,577

[1]The Company has a Stock Buyback Program (the Program) which was originally announced on January 30, 1985. Under the Program, the Company may repurchase its shares from time to time, either in the open market or through private transactions, whenever it appears prudent to do so. On December 15, 2003, the Company authorized an additional 1 million shares for repurchase pursuant to its Program. The Program has no expiration date, and the Company from time to time may authorize additional increases of 1 million share increments for buyback authority so as to maintain the Program.

The following graph compares the cumulative total stockholder return on the Company s Common Stock as of the end of each of the last five fiscal years, with the cumulative total stockholder return on the Standard & Poor s Small Cap 600 (Industrial Segment) Index and on the Russell 2000 Index, assuming an investment of $100 in each at their closing prices on June 30, 2004 and the reinvestment of all dividends.

Item 6. Selected Consolidated Financial Data

Selected financial data for the five years ended June 30, 2009 is as follows:

See Item 7 for discussions on comparability of the below.

	2009	2008	2007	2006	2005
SUMMARY OF OPERATIONS (in thousands)					
Net sales					
Food Service Equipment	$350,358	$381,254	$299,009	$245,049	$230,392
Air Distribution Products	66,534	88,334	110,081	129,383	129,716
Engraving	77,311	92,167	84,223	87,377	77,271
Engineering Technologies	51,693	51,615	41,829	37,616	39,428
Electronics and Hydraulics	61,190	84,171	86,069	90,513	82,671
Total	$607,086	$697,541	$621,211	$589,938	$559,478
Gross profit	$175,975	$201,847	$172,804	$172,614	$160,564

Operating income					
Food Service Equipment (a)	$9,900	$31,460	$18,242	$18,771	$20,578
Air Distribution Products	713	(340)	2,610	11,089	7,424
Engraving	7,028	9,611	7,595	12,835	9,904
Engineering Technologies	8,667	9,770	6,824	6,665	8,125
Electronics and Hydraulics	3,459	8,106	9,158	9,257	9,069
Restructuring (b)	(7,839)	(590)	(286)	(930)	(2,668)
Other Operating Income	--	--	1,023	410	1,672
Corporate	(15,907)	(19,088)	(15,069)	(19,346)	(18,277)
Total	$6,021	$38,929	$30,097	$38,751	$35,827
Interest expense	(6,532)	(9,510)	(9,025)	(7,681)	(6,493)
Other Non-Operating Income	215	324	1,464	893	523
Provision for income taxes	(1,594)	(10,459)	(6,611)	(11,028)	(9,382)
Income from continuing operations	(1,890)	19,284	15,925	20,935	20,475
Income/(loss) from discontinued operations	(3,515)	(774)	5,317	2,208	3,168
Net income	($5,405)	$18,510	$21,242	$23,143	$23,643

(a)

Includes $21.3 million of impairment of goodwill and intangible assets during 2009.

(b)

See discussion of restructuring activities in Note 16 of the consolidated financial statements.

Financial results after January 1, 2007, reflect the acquisition of Associated American Industries and American Foodservice.

PER SHARE DATA					
Basic					
Income from continuing operations	($0.15)	$1.57	$1.30	$1.71	$1.67
Income/(loss) from discontinued operations	(0.29)	(0.06)	0.44	0.18	0.26
Total	($0.44)	$1.51	$1.74	$1.89	$1.93
Diluted					
Income from continuing operations	($0.15)	$1.55	$1.28	$1.67	$1.65
Income/(loss) from discontinued operations	(0.29)	(0.06)	0.43	0.18	0.26
Total	($0.44)	$1.49	$1.71	$1.85	$1.91

Dividends paid	$0.68	$0.84	$0.84	$0.84	$0.84

	2009	2008	2007	2006	2005
BALANCE SHEET AND CASH FLOW					
Total assets	$433,709	$523,034	$539,900	$478,673	$442,306
Accounts receivable	81,893	103,055	106,116	99,310	93,676
Inventories	75,634	87,619	91,301	91,719	86,836
Accounts payable	(58,802)	(66,174)	(65,977)	(62,742)	(58,379)
Goodwill	101,722	120,650	118,911	73,272	65,339
Long-term debt	$94,300	$106,086	$164,158	$113,729	$53,300
Short-term debt	--	28,579	4,162	3,873	52,213
Total debt	94,300	134,665	168,320	117,602	105,513
Less cash	8,984	28,657	24,057	32,590	23,691
Net debt	85,316	106,008	144,263	85,012	81,822
Stockholders' equity	176,286	223,158	204,431	200,295	175,553
Depreciation and amortization	$15,541	$17,113	$15,198	$12,033	$10,907
Capital expenditures	$5,689	$10,989	$10,341	$15,144	$7,990
Operating cash flow from continuing operations	$43,273	$45,183	$32,497	$31,557	$18,244

Accounts receivable, inventories, and accounts payable in the above table include the applicable amounts from discontinued operations in fiscal years 2005 and 2006

KEY STATISTICS	**2009**	**2008**	**2007**	**2006**	**2005**
Gross profit margin	28.99%	28.94%	27.82%	29.30%	28.70%
Operating income margin (a)	0.99%	5.58%	4.84%	6.57%	6.40%

(a) Includes $21.3 million of impairment of goodwill and intangible assets during 2009.

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

Overview

We are a leading manufacturer of a variety of products and services for diverse commercial and industrial market segments. We have five reporting segments: Food Service Equipment Group, Air Distribution Products Group (ADP), Engraving Group, Engineering Technologies Group, and Electronics and Hydraulics. We are a manufacturer of products sold to commercial and industrial customers. This has enabled us to align all of our businesses with our core manufacturing competencies. Our continuing objective is to identify those of our businesses which hold the greatest potential for profitable growth, and direct our resources to supporting both organic growth and acquisition opportunities in those businesses.

In the recessionary environment in which we have operated during the past year, our focus has been on aggressively reducing the costs throughout all of our operations. To that end, we have reduced the total size of the US based work force, including both office and shop floor personnel, by approximately 25% during the course of the year. Since the beginning of fiscal 2009 we reduced our U.S.-based salaried and indirect labor staffing levels by approximately 260 positions resulting in annual savings of approximately $14 million. In addition, during the third quarter, except where prohibited by collective bargaining agreements, we announced that employee salaries would be frozen and employer contributions to defined contribution plans would be suspended through at least the end of calendar year 2009. Finally, we have eliminated all annual incentive bonus payments and long term management incentive payouts for fiscal year 2009.

We also, as part of our ongoing efforts to improve the utilization of our manufacturing infrastructure, have accelerated the implementation of plans to consolidate our global manufacturing footprint as outlined below:

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In our ADP Group we closed our Bartonville, Illinois, facility during the first quarter and transferred its production to two of our existing ADP facilities.

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In our Food Service Equipment Group we announced the closure of a facility located in New York in the third quarter and successfully completed the transfer of the production from this facility to our operations in Mexico and Wyoming. Also during the fourth quarter, we began the consolidation of another Food Service Equipment group facility, the APW Wyott facility located in Dallas, into our Nogales, Mexico facility. We expect to complete this latest consolidation during the first half of 2010.

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In our Engraving Group, we completed the consolidation of two roll engraving operations into our Richmond, Virginia facility during the first quarter. In the third quarter, we consolidated the mold texturizing production at our Detroit facility into our facility located in Canada.

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In our Electronics and Hydraulics Group, we completed the consolidation of the production from our remaining Canadian Electronics operation into existing facilities located in Mexico and China during the fourth quarter. We also announced the consolidation of the production of the BG Labs business which we acquired in August 2008 into our

facilities in Cincinnati, Ohio. This consolidation will be completed in the first quarter of 2010. We closed a manufacturing operation in the Hydraulics unit during the second quarter and consolidated production into an existing facility.

The annual savings to be achieved by the plant consolidations completed in 2009 is estimated to be $10 million. The Food Service plant consolidation scheduled to be completed by the end of calendar 2009 will yield an estimated additional $2.5 million in annual savings.

In addition to headcount reductions, we achieved cost reductions in all aspects of procurement including purchase of inventory items, maintenance and repair supplies and services. We also focused on driving improved productivity from our internal operations including shop floor productivity, reduced scrap and warranty expense and reductions in other controllable expense categories. In the procurement and productivity cost categories we achieved annual cost savings in excess of $12 million which became fully implemented at the end of the fourth quarter of 2009.

Further, we continue our strong focus on working capital management and cash flow generation with the intent of improving our liquidity and making additional payments on borrowings under the Company s revolving credit facility. In addition, the Company is repatriating cash in instances where the Company can remit to the U.S. without incurring a significant net tax cost, as well as restricting capital expenditures. The strong operating cash flow from continuing operations of $43.3 million and resulting debt reduction of $40.4 million for the full fiscal year indicate that these actions have also been successful. The resulting additional borrowing capacity is expected to provide additional financial flexibility for the foreseeable future.

The cost reduction initiatives outlined above that were completed in 2009 will deliver a total of $36 million in annualized savings. Approximately $15.5 million of this total savings was realized in 2009 and the remaining $20.5 million will be realized in 2010.

Because of the diversity of the Company s businesses, end user markets and geographic locations, management does not use specific external indices to predict the future performance of the Company, other than general information about broad macroeconomic trends. Each of our individual business units serves niche markets and attempts to identify trends other than general business and economic conditions which are specific to their businesses and which could impact their performance. Those units report any such information to senior management, which uses it to the extent relevant to assess the future performance of the Company. A description of any such material trends is described below in the applicable segment analysis.

We monitor a number of key performance indicators including net sales, income from operations, backlog and gross profit margin. A discussion of these key performance indicators is included within the discussion below.

Unless otherwise noted, references to years are to fiscal years.

Consolidated Results from Continuing Operations (in thousands):

	2009	**2008**	**2007**
Net sales	$607,086	$697,541	$621,211
Gross profit margin	29.0%	28.9%	27.8%
Restructuring expense	($7,839)	($590)	($286)

Income from operations	$6,021	$38,929	$30,097
Backlog	$96,335	$111,663	$113,844

Net Sales

	2009	2008	2007
Net sales, as reported	$607,086	$697,541	$621,211
Components of change in sales:			
Effect of acquisitions	--	$51,285	$57,839
Effect of exchange rates	($10,528)	$10,262	$5,313
Organic sales/(decline) growth	($79,927)	$14,783	($31,879)

Net sales decreased $90.5 million in 2009, a 13.0% decrease from the prior year. Organic sales decreased $79.9 million or 11.5%, with the remaining difference due to exchange rates. While we experienced a recession-driven decrease in sales across all segments except for the Engineering Technologies Group, sales in our ADP and Electronics and Hydraulics segments had the most significant declines, as downturns in the housing, white goods, and heavy truck industries impacted the sales of these segments.

Net sales increased $76.3 million in fiscal 2008, a 12.3% increase from the prior year. The net sales increase was positively impacted by the full year impact of our 2007 acquisitions and favorable exchange rates. Organic sales grew $14.8 million or 2.4%. Sales in our ADP and Electronics and Hydraulics Products segments experienced declines, as downturns in the housing and heavy truck industries impacted the sales of these segments. Discussion of the performance of all our segments is more fully detailed below.

Gross Profit Margin

Our gross profit margin increased in 2009 to 29.0% from 28.9% in 2008. This increase in margin is due to our efforts to reduce our cost structure, as reductions in materials and value added costs were able to outpace the natural inefficiencies resulting from our decrease in sales. We believe that our cost reduction efforts will better position our operations for higher gross margins when a macroeconomic recovery occurs. Our gross profit margin increased in fiscal 2008 to 28.9% from 27.8% in 2007.

Restructuring

On July 25, 2008, the Company announced the closure of the ADP production facility located in Bartonville, Illinois. The Company s decision to close the Bartonville facility was in response to the Company s lean initiatives, excess capacity, and the continuing decline in the new residential construction market. The sales and production activities at the Bartonville facility were relocated to other ADP facilities. Standex recorded a $4.6 million pre-tax expense related

to the closure of the Bartonville facility during 2009.

In the second quarter of 2009, the Company closed the Bessemer, Alabama, manufacturing and distribution facility of its Hydraulics unit within the Electronics and Hydraulics Group. Production from this plant was consolidated into our other Hydraulics operation in Ohio.

In January 2009, the Company announced the consolidation of three facilities, one each in the Food Service Equipment, Engraving, and Electronics and Hydraulics groups. Production at these locations will be integrated into existing facilities throughout the world in their respective divisions. Related restructuring expenses of $1.9 million were incurred during the year for these consolidations.

The Company has reduced its US based employment by 25% across all divisions in order to reduce costs in response to the macroeconomic recessionary environment and its expected effects on the Company in the immediate future. The Company recorded $1.3 million of pre-tax restructuring expense related to this initiative during 2009.

Income from Operations

Income from operations during 2009 decreased $32.9 million, or 84.5% when compared to 2008. This includes the impact of $21.3 million of impairment of goodwill and intangible assets during the year, as well as restructuring costs of $7.8 million during the year. Absent these costs, income from operations decreased $3.7 million, or 9.6%, from 2008, which is attributable to the 13% year-over-year decline in sales offset by the aforementioned improvements in our cost structure.

Income from operations during 2008 increased $8.8 million, or 29.3% when compared to 2007. Excluding the impact of acquisitions, the increase was $5.3 million or 17.6%. This increase is due to several factors including cost reductions and improvements in productivity at a number of the Company s divisions, profit leverage resulting from a 2.4% organic sales growth, and reduced U.S. pension plan expense due to the freezing of the salaried defined benefit plan.

Discussion of the performance of all of our Groups is more fully explained in the segment analysis that follows.

Income Taxes

The Company s income tax provision from continuing operations for the fiscal year ended June 30, 2009 was $1.6 million, or an effective rate of (539.0%), compared to $10.5 million, or an effective rate of 35.2%, for the fiscal year ended June 30, 2008 and $6.6 million, or an effective rate of 29.3%, for the fiscal year ended June 30, 2007. Changes in the effective tax rates from period to period may be significant as they depend on many factors including, but not limited to, size of the Company s income or loss and any one time activities occurring during the period.

The Company s income tax provision from continuing operations for the fiscal year ended June 30, 2009 was significantly impacted by the following items (i) a benefit of $0.8 million from the reversal of income tax contingency reserves that were determined to be no longer needed due to the expiration of applicable limitation statutes, (ii) the $21.3 million impairment for which only $1.3 of tax benefit could be realized, as the goodwill had no tax basis, (iii) a benefit totaling $1.7 million from the reversal of the deferred tax liability that was no longer required due to a change in the U.S. tax classification of one of our foreign entities, (iv) a benefit of $0.6 million related primarily to the retroactive extension of the R&D credit recorded during the second quarter and (v) a benefit related to the receipt of $1.1 million of nontaxable life insurance proceeds during the first quarter.

Capital Expenditures

In general, our capital expenditures over the longer term are expected to be approximately equivalent to our annual depreciation costs. In 2009, capital expenditures of $5.7 million were below our annual depreciation of $12.3 million and reflect our strategy of cash conservation and debt reduction in response to the current recessionary environment. In 2008, our capital expenditures were $11.0 million.

Backlog

Backlog at June 30, 2009 decreased $15.3 million to $96.3 million when compared to fiscal 2008, a 13.7% decrease when compared to prior year. This decrease is correspondent with our decrease in sales volume as a result of the broader economic climate, and is across all segments, with the exception of a slight increase for the Engraving Group.

Segment Analysis

Net Sales

The following table presents net sales by business segment (in thousands):

	2009	2008	2007
Food Service Equipment	$350,358	$381,254	299,009
Air Distribution Products	66,534	88,334	110,081
Engraving	77,311	92,167	84,223
Engineering Technologies	51,693	51,615	41,829
Electronics and Hydraulics	61,190	84,171	86,069
	$607,086	$697,541	$621,211

Food Service Equipment

Net sales in 2009 decreased $30.9 million, or 8.1%, from 2008. The effects of foreign exchange rates accounted for $3.7 million of the decline. When removing the effect of foreign exchange rate impact, sales decreased $27.3 Million, or 7.2%, when compared with the same period one year earlier. We achieved slight organic growth in our Refrigerated Solutions businesses (walk-in cooler and refrigerated cabinets) generally due to market share gains and nominal price increases. Our Cooking Solutions and Custom Solutions businesses experienced sales declines primarily due to the market deterioration that began in the second fiscal quarter.

Fiscal 2008 net sales in the Food Service Equipment Group (FSEG) increased $82.2 million when compared to fiscal 2007, a 27.5% increase to $381.3 million. Acquisitions accounted for $51.3 million of the sales increase. The acquisition growth was due to the full year impact of the Associated American Industries (AAI) and American Food Service acquisitions completed in 2007. Favorable exchange rate gains accounted for approximately $2.7 million (+0.9%) of the segment s sales increase. Organic sales growth of $28.2 million (+9.5%) accounted for the remainder of the growth. All FSEG major brands experienced positive organic growth through a combination of market share gains, price increases, moderate growth of core markets, broadening our customer base and expanding into new markets.

Air Distribution Products

Net sales for 2009, declined $21.8 million, or 24.7% from the prior year. Standex evaluates the available market for ADP by monitoring new housing start data, published monthly by the U.S. Department of Housing and Urban Development. Sales to the Group s customers typically lag new home starts by three to four months. A volume decline of 34.3% was driven by a similar decline in housing starts of 36.8 % during the year. ADP continues to pursue market share gains through its traditional wholesaler channels by expanding its sales force, focusing on underpenetrated markets, and by adding new, adjacent product offerings, such as flex duct. These initiatives have resulted in market share gains; however, the sales volume increases resulting from these gains are marginal compared to overall market deterioration.

ADP s fiscal 2008 sales declined $21.7 million from fiscal 2007 levels, a 19.8% reduction. The decrease in ADP s volume was due to the continuing, significant decline in new residential construction offset partially by market share gains. During fiscal 2008 the housing starts deteriorated by over 24% while during the same period ADP s sales, adjusted for price changes, were lower by 23%.

Engraving

Sales in the Engraving Group decreased by $14.9 million, or 16.1% from fiscal 2008 levels. The largest industry served by the mold texturization business, a significant part of the Group, is the automotive industry. Sales in this industry are driven by the number of new and redesigned platforms that the OEM s introduce during the year. The Group experienced a widespread decrease in sales of mold texturizing for automotive OEM platform work in most geographic regions, especially Europe, in 2009 due to OEM s launching fewer new auto platforms and delaying current programs. Lower mold texturing sales were partially offset by stronger sales in core forming tools and filtration screens related to our Innovent business. North American operations sales declined 12.8% and international operations sales declined 22.5%. Although this has been a challenging year, we believe that our global presence, as well as our ability to be very responsive to our automotive OEM customers needs will continue to allow us to leverage our customers desire to work with one company worldwide while meeting their requirements for design and production consistency.

During 2008, sales in the Engraving Group increased by $7.9 million, or 9.4%, from the fiscal 2007 level. Sales growth was driven primarily in mold texturization. These results were partially offset by weakness in the roll, plate and machinery business which was negatively impacted by slowdowns in the automotive and housing markets. Net sales increased by $2.2 million when compared to fiscal 2007 after excluding the effects of foreign exchange which added $5.7 million. During fiscal 2008, sales to the automotive industry experienced an increase due to market share gains, strong demand from our automotive OEM customers in North American and Europe, growth in our China operations as well as very solid performance in our European businesses.

Engineering Technologies

Sales increased $0.1 million in fiscal 2009 when compared to the prior year. Our metal spinning and fabrication businesses, which serve customers in the energy, marine, aviation, missile and aerospace industries, experienced steady performance. We secured new contracts for tank systems for the growing unmanned aerial vehicles market and contracts for tooling and hardware related to NASA s Orion and Ares rocket programs. In addition this group saw an increase in demand for land based turbine components.

2008 sales in this Group increased $9.8 million, or 23.4%, when compared to the prior year. The energy, aerospace, and aviation industries increasingly sourced fabricated metal parts from third parties rather than manufacturing these parts themselves, which benefited our spinning and fabrication businesses. During 2008, one of our metal spinning businesses recognized $5.1 million of revenue on a contract for tooling and hardware related to NASA s Orion rocket

program.

Electronics and Hydraulics

Sales declined by $23.0 million, or 27.3% in 2009 when compared to the same period one year earlier. For the Electronics unit, the decline is attributable to the global recession in the automotive, white goods and HVAC market segments, which experienced steep declines during the second half of fiscal 2009. Within the Hydraulics unit, the global decline in new orders for dump trucks and dump trailers has been dramatic, as the recession has resulted in a general lack of credit availability for buyers, as well as an excess of used and repossessed equipment flooding the market. Many difficult yet necessary steps have been undertaken to re-position the Group, including significant layoffs and plant closings in both units, and the Group is focusing on new products and non-traditional applications for our products as a means to achieve organic growth.

Sales declined by $1.9 million, or 2.2% in fiscal 2008 when compared to the same period one year earlier. Relatively flat year over year sales at our Electronics business were attributable to weakness in the automotive, security, HVAC and white goods markets, offset by new business in the medical and controls markets. In the Hydraulics unit, declines in the U.S. market were driven by several factors, including new EPA regulations, dramatic increases in the price of fuel, and the general slowdown in the construction sector.

Income from Operations

The following table presents income from operations by business segment (in thousands):

	2009	**2008**	**2007**
Food Service Equipment	$9,900	$31,460	18,242
Air Distribution Products	713	(340)	2,610
Engraving	7,028	9,611	7,595
Engineering Technologies	8,667	9,770	6,824
Electronics and Hydraulics	3,459	8,106	9,158
Restructuring	(7,839)	(590)	(286)
Other income, net	-	-	1,023
Corporate	(15,907)	(19,088)	(15,069)
	$6,021	$38,929	$30,097

Food Service Equipment

Income from operations (our measure of segment profit performance) for fiscal 2009 decreased approximately $21.6 million, or 68.5%, when compared to the same period one year earlier. Excluding the effect of a $21.3 million impairment of goodwill and intangible assets during the third quarter, operating income was approximately flat year-over-year. An 8.1% decline in sales volume was offset by staffing reductions, material and labor productivity improvements, and nominal price increases. These savings initiatives were partially offset by commodity cost increases in the first half and negative sales mix in the first quarter.

Income from operations increased $13.2 million from $18.2 million in fiscal 2007 to $31.5 million in fiscal 2008, a 72.5% increase. The full year impact of acquisitions completed in fiscal 2007 added approximately $3.5 million in income from operations during fiscal 2008. Excluding the impact of acquisitions, income from operations increased $9.7 million, or 53.1%, compared to fiscal 2007. Our Master-Bilt and Nor-Lake divisions experienced operating income growth in excess of 75% driven by organic sales growth, price increases, cost reductions and improved manufacturing efficiencies in all manufacturing locations. Our Procon pump business experienced a 38% improvement in operating income due to organic sales growth, exchange gains, material cost reduction programs and operational improvements in their Mexico and Ireland operations.

Air Distribution Products

Operating income for 2009 was $0.7 million, an increase of $1.1 million from 2008. Price increases implemented in early 2009 partially offset raw steel price increases and declining sales volume. These raw material price increase were also offset by significant year over year cost savings achieved from the shutdown of the Bartonville, Illinois, facility in July 2008 and salaried and hourly workforce reductions which took place primarily in the third quarter of the year. Additionally, the Group recorded expenses of $3.5 million during the third quarter of 2009 to write down inventory of higher-cost metal purchased in the first half the year to its fair market value.

Fiscal 2008 income from operations decreased $3.0 million from prior year. The decrease is due primarily to sales volume declines and to a lesser extent, material cost increases. Metal costs escalated more than 49% during the period. Specific raw material cost reduction strategies along with third and fourth quarter price increases helped to partially offset these cost escalations.

Engraving

Income from operations decreased by $2.6 million, or 26.9%, to $7.0 million when compared to fiscal 2008. Restructuring measures taken during the year consist of the completion of the closure of our Ohio mold texturizing and New Jersey roll embossing facilities begun in 2008, and an additional consolidation during the year of our Michigan mold texturizing facility. In addition, the Group continued to expand the use of Lean enterprise techniques throughout its operations in order to further improve profitability and responsiveness to our customers.

Income from operations increased by $2.0 million, or 26.5%, when compared to fiscal 2007. Sales volume increases and productivity improvements in the world wide mold texturizing facilities led to significant profit growth in this portion of the Engraving Group. In the mold texturizing business we opened a new facility in Turkey and a larger facility in the Czech Republic which contributed to positive earnings growth during the year. Operating income was down year over year in the roll and plate engraving and embossing equipment businesses due primarily to the impact of lower volume resulting from the downturn in the U.S. housing and automotive market, where a large percentage of this unit s products are applied.

Engineering Technologies

Income from operations decreased $1.1 million or 11.3% in fiscal 2009 when compared to the same period one year earlier. The reduced profitability was the result of a shift in mix to lower margin products for the energy markets and away from aerospace sales. The introduction of lean manufacturing techniques as a regular element of daily production is helping to improve margins in this segment.

Income from operations increased $2.9 million, or 43.2% in fiscal 2008 when compared to the same period one year earlier. The improvement in income from operations was attributed to the growth in aerospace and energy sales coupled with cost reductions. The improvement in operating income resulting from these efforts was partially offset by production inefficiencies due to the commissioning of new capital equipment and new product launches.

Electronics and Hydraulics

Income from operations decreased $4.6 million in fiscal 2009, or 57.3% when compared to the same period one year earlier, due primarily to the year over year sales decline of over 25%. Sales demand for this segment was negatively impacted by recessionary market conditions that existed in the automotive, housing white goods and off road construction vehicles end user segments. In the Electronics unit, aggressive cost reduction measures and plant closures resulted in a moderate increase in earnings as a percent of net sales. In the Hydraulics unit, we have successfully introduced new capital equipment to improve productivity and closed one facility.

Income from operations decreased $1.1 million in fiscal 2008, or 11.5% when compared to the same period one year earlier. While income from operations was positively impacted by cost reductions achieved through Lean manufacturing techniques and the use of low cost manufacturing in Mexico and China, these efforts were offset by labor inefficiencies associated with the closure of a Canadian manufacturing facility in the Electronics unit during 2008. These issues were resolved by the end of the year.

Corporate

Corporate expenses decreased $3.2 million, or 16.7% during 2009. The reduction in corporate expenses can be attributed to a salaried headcount reduction of over 25%, as well as the suspension of bonuses during the year in response to the recessionary macroeconomic environment. Also, in 2009, there was no expense for current-year awards under the Company s performance-based long term stock compensation program, as we determined that the achievement of the performance criteria for outstanding awards was not probable, whereas in 2008 these awards resulted in expense of $1.3 million.

Corporate expenses increased $4.0 million, or 26.7%, during 2008. This increase is primarily due to increased stock-based compensation expense as compared to 2007. During 2007 the accruals made for performance-based grants issued between 2005 and 2007 were reversed when we determined that the achievement of the performance criteria for outstanding awards was not probable. The net effect of reversing these accruals was a $2.1 million reduction to stock-based compensation expense in fiscal 2007. In fiscal 2008 we recorded approximately $1.3 million of expense for the long-term stock compensation program for grants made in fiscal 2008.

Discontinued Operations

In 2007, the Company sold substantially all the assets of the Berean Christian Stores (Berean) business in an all cash deal resulting in the recognition of a pre-tax gain of $0.2 million. As the former owner of Berean, the Company is party under a number of operating leases which were assigned to the purchaser of the business for the remaining initial terms of the leases at the stated lease costs. The Company remained the guarantor of these leases until the expiration of the initial terms. In the second quarter of 2009, noting Berean s deteriorating operating performance and precarious financial position, the Company recorded liabilities of $2.9 million, net of estimated subleases, in anticipation of the impairment of leases remaining under the obligation.

In June 2009, Berean filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code and, in July 2009, its assets were sold to a third party under Section 363 of the Code. The new owner of the Berean assets is infusing capital into the business, and we believe the Berean bookstores can now be operated successfully as a going concern. As part of this transaction, the Company agreed to provide lease supplement payments to the new owner of the Berean assets. These payments included an upfront payment of $0.5 million and additional payments totaling $1.2 million which will be made in equal monthly installments through December 2011. The Company will remain a guarantor of the leases assumed by the new owner, however, our guarantee has been reduced for locations where the new owner was able to obtain rent concessions. In addition, the Company remains a guarantor of three sites formerly operated by Berean. Liabilities associated with these three guarantees, net of expected subleases at current market rates, total $1.1 million at June 30, 2009. Subsequent to these transactions, the total amount of remaining lease payments guaranteed by the Company was $6.1 million.

During 2008, the Company entered into an Administrative Order of Consent with the U.S. Environmental Protection Agency (EPA) related to the removal of various PCB-contaminated materials and soils at a site where the Company leased a building and conducted operations from 1967-1979. The Company established an accrual of $2.0 million related to the matter in 2008 and an additional $2.0 million accrual in 2009. Remediation efforts were substantially completed during the third quarter of 2009, and the Company anticipates receiving a closure letter from the EPA in the first half of 2010.

The Company has initiated litigation against our legacy insurance carriers and is actively involved in negotiations surrounding coverage and cost recovery of amounts spent regarding environmental remediation at this site, however, the amount and timing of any potential recovery cannot currently be estimated. See the notes to our consolidated financials statements for further information regarding this event.

During the second quarter of 2007, the Company was able to complete the sale of the under-sink food disposals product line of USECO, resulting in a gain on the sale of approximately $0.5 million offset by losses from the other USECO operations. In the third quarter of fiscal 2007, the Company determined that the remaining USECO rethermalization systems business could not be sold, and accordingly, shutdown the operations, accelerating the depreciation expense on the remaining manufacturing equipment and ceasing the manufacturing operations. Any inventory remaining was analyzed and, where usable and transferable to our other businesses, was transferred to current operations. The remaining inventory was previously fully reserved for. In connection with the shutdown, the Company retained the warranty risk for previously sold units. The Company has analyzed those needs and believes that the current recorded balance of $0.2 million is sufficient to cover future costs to support warranty claims.

In 2007, the Company sold substantially all the assets of the Standard Publishing business in an all cash deal and recognized a pre-tax gain of $10.1 million in this transaction. During fiscal 2008, the Company sold certain land, buildings and improvements related to Standard Publishing for net proceeds of $1.6 million in cash. The Company recorded a gain on disposal of $0.9 in connection with the sale.

The following table summarizes the Company s discontinued operations activity, by operation, for the years ended June 30, 2009, 2008 and 2007:

Division Disposed Of	**Year Disposed**	**2009**	**2008**	**2007**
Berean Christian Bookstores	2007	$ (3,057)	$ --	$ 200
Club Products and Monarch Aluminum	1982	(2,065)	(2,000)	--
Standard Publishing	2007	--	1,034	10,100
USECO	2007	--	--	(1,435)
Other loss from discontinued operations		(492)	(284)	(218)
Income (loss) before taxes from discontinued operations		$(5,614)	$(1,250)	$ 8,647

(Provision) benefit for tax	2,099	476	(3,330)
Net income (loss) from discontinued operations	$(3,515)	$ (774)	$ 5,317

Liquidity and Capital Resources

Cash Flow

Cash flows from continuing operations for the year ended June 30, 2009, were $43.3 million compared to $45.2 million for the same period in 2008. Despite the impact of a $21.2 million decrease in income from continuing operations, cash flows remained strong due to good working capital management during the period, which, net of prepaid items and accruals, contributed $25.8 million to operating cash flows during the year. Excluding the impact of foreign exchange, the changes in working capital reflect reduced accounts receivable totaling $21.2 million and a reduction in inventories generating $12.0 million in additional cash flow, partially offset by a $7.4 million reduction in accounts payable.

We used $7.2 million of cash for investing activities during 2009, including $5.2 million for capital expenditures. We also used $5.6 million for acquisitions, consisting of a small acquisition within the Electronics and Hydraulics Group and the purchase of the Richmond, Virginia, Engraving Group facility triggered by the fulfillment of a contingent purchase requirement from the 2003 acquisition of IR International. These cash outflows were offset by life insurance proceeds of $3.8 million resulting from the death of a former executive and the penalty-free withdrawal of excess funding from our policies.

During the year ended June 30, 2009, we used $49.9 million of cash for financing activities. During the fourth quarter of 2009, the Company determined that it would be advantageous to retire its remaining fixed rate debt ahead of schedule. Based on this determination, the Company used its operating cash flow to repay the 5.94% debt early. The additional premium paid and write-off of unamortized debt issuance costs in connection with this extinguishment were not material. We paid dividends of $8.4 million and made net repayments of debt of $40.7 million (including early extinguishment premium) during the period. Borrowings and repayments of debt during the period also reflect payments in the second quarter related to the maturity of the Company s fixed rate borrowings of $25.0 million

Our customer base in the food service equipment, automotive, U. S. residential housing and general industrial sectors have all experienced difficult recessionary market conditions. These recessionary trends have led to a reduction in our sales volume. To offset the impact of the reduced sales volume, management has implemented a number of cost reduction and cash management initiatives as described above that will save the Company in excess of $36 million annually. In addition, we have reduced our level of capital expenditures and emphasized working capital management. We reduced working capital by 20.7% ($25.8 million) year over year. Inventory was reduced by $12.0 million. We were able to reduce the Company s overall raw materials on hand by $5.3 million year over year, excluding ADP s raw material. Note that ADP generally has a higher concentration of raw materials than the rest of the company due to the nature of the business (i.e. manufacturing process and short lead times to our customers).

Capital Structure

We have in place a five year, $150 million unsecured revolving credit facility (the facility) with seven participating banks which originated in September 2007. The Company also has an optional $75 million accordion feature under the facility. Funds available under the facility may be used for general corporate purposes or to provide financing for acquisitions. Borrowings under the agreement bear interest at a rate equal to LIBOR plus an applicable percentage based on our consolidated leverage ratio, as defined by the agreement. As of June 30, 2009, the effective rate of interest for outstanding borrowings under the facility was 4.11%. We are required to pay an annual fee of 0.15% on the maximum credit line.

The Company has undertaken a series of initiatives to generate cash and reduce debt, including cost reductions, improved working capital management, repatriation of foreign cash, and plant consolidations. These initiatives have enabled us to pay down substantially all of our private placement debt. As of June 30, 2009, we had borrowings of $91.0 million under the facility. We believe that the remaining $59.0 million available provides us with sufficient capacity to meet both our short- and long-term liquidity needs.

Our funded debt agreements contain certain customary affirmative and negative covenants, as well as specific financial covenants. The Company s current financial covenants under the facility are as follows:

Interest Coverage Ratio - The Company is required to maintain a ratio of Earnings Before Interest and Taxes (EBIT) to interest expense for the trailing twelve months of at least 3:1. EBIT is defined in the revolving credit facility to specifically exclude extraordinary and other non-recurring items such as non-cash restructuring charges and goodwill impairment. At June 30, 2009, the Company s Interest Coverage Ratio was 4.78:1.

Leverage Ratio - The Company s ratio of funded debt to trailing twelve month EBITDA, defined as EBIT plus Depreciation and Amortization, may not exceed 3.5:1. At June 30, 2009, the Company s Leverage Ratio was 2.02:1.

Consolidated Net Worth The Company is required to maintain a Consolidated Net Worth of at least $163.7 million plus 50% of cumulative net income since the inception of the agreement. Consolidated Net Worth is defined as the Company s net worth as adjusted for unfunded pension liabilities (not to exceed $40 million) and certain foreign exchange gains and losses. At June 30, 2009, the Company s Consolidated Net Worth was $207.4 million, $8.5 million greater than the required amount of $198.9 million.

We also utilize two uncommitted money market credit facilities to help manage daily working capital needs. These unsecured facilities, which are renewed annually, provide for a maximum aggregate credit line of $20 million. No amounts were outstanding under these facilities at June 30, 2009 and 2008. At June 30, 2009, and 2008, we had standby letters of credit outstanding, primarily for insurance purposes, of $14.3 million and $14.9 million, respectively

Our primary cash requirements in addition to day-to-day operating needs include interest and mandatory principal payments, capital expenditures, and dividends. Our primary sources of cash for these requirements are cash flows from continuing operations and borrowings under the facility. We expect to spend between $6-10 million on capital

expenditures during 2010, and expect that depreciation and amortization expense for the year will be approximately $12.0 million and $2.5 million, respectively.

In July 2008, we entered into a series of swap agreements with one and two year terms effectively converting interest payments on our long-term debt from variable to fixed rates. We converted interest payments on $88.5 million of debt due under the facility from variable rates based on LIBOR to a weighted average effective rate of 4.01% based on our current leverage ratio. The one year swaps totaling $22.5 million expired in July 2009. The two years swaps totaling $60 million will expire in July 2010.

The following table sets forth our capitalization at June 30:

Year Ended June 30 *(in thousands)*:	**2009**	**2008**
Short-term debt	$ --	$28,579
Long-term debt	94,300	106,086
Total debt	94,300	134,665
Less cash	8,984	28,657
Total net-debt	85,316	106,008
Stockholders equity	176,286	223,158
Total capitalization	$261,602	$329,166

Stockholders equity decreased year over year primarily as a result of the net loss of $5.4 million, which was driven by non-cash impairment of goodwill and intangible assets of $21.3 million, dividends of $8.9 million, unfavorable foreign currency movements of $10.4 million and pension losses of $23.5 million. The remaining changes are attributable to the treasury stock activity offset by the additional paid in capital increases associated with stock option exercises and stock-based compensation in the current year. The Company's net debt to capital percentage increased from 32.2% to 32.6% in 2009 due to a net loss coupled with the aforementioned other comprehensive losses in currency and pension.

We sponsor a number of defined benefit and defined contribution retirement plans. The Company s pension plan for U.S. salaried employees was frozen as of January 2008. All participants in the U.S. salaried pension plan and the supplemental defined benefit plan no longer accrue future benefits. The fair value of the Company's U.S. pension plan assets was $149.7 million at June 30, 2009 and the accumulated benefit obligation in the U.S. was $186.2 million at that time. There were $0.3 million of cash contributions to our defined benefit plans in 2009 and $0.6 million of contributions are estimated to be required in 2010.

During the third quarter of 2009, the Company announced that it would suspend employer matching contributions to its 401(k) plans, with the exception of obligations under collective bargaining agreements. This suspension began in

April 2009 and will continue until at least the end of calendar year 2009.

We have evaluated the current and long-term cash requirements of our defined benefit and defined contribution plans as of June 30, 2009. Our operating cash flows from continuing operations and available liquidity are expected to be sufficient to cover required contributions under ERISA and other governing regulations.

We have an insurance program for certain retired key executives. The underlying policies have a cash surrender value of $18.6 million and are reported net of loans of $12.0 million for which we have the legal right of offset. These policies have been purchased to fund supplemental retirement income benefits. The aggregate present value of future obligations was $1.4 million and $1.7 million at June 30, 2009 and 2008, respectively. During 2009, the Company withdrew $1.9 million of excess funding from these policies with no related tax consequences and received $1.9 million of cash proceeds upon the death of a former executive covered by this program.

Contractual obligations of the Company as of June 30, 2009 are as follows (in thousands):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Long- and short-term debt obligations	$94,300	$ --	$ --	$91,000	$3,300
Operating lease obligations	15,988	4,723	5,700	2,729	2,836
Estimated interest payments [1]	5,138	2,776	2,012	284	66
Post-retirement benefit payments [2]	1,604	168	338	321	777
Purchase obligations	1,582	1,582	--	--	--
Other [3]	1,681	1,006	675	--	--
Total	$120,293	$10,255	$8,725	$94,334	$6,979

1 Estimated interest payments are based upon effective interest rates as of June 30, 2009, and includes the impact of interest rate swaps. See Item 7A for further discussions surrounding interest rate exposure on our variable rate borrowings.

2 Post-retirement benefit payments are based upon current benefit payment levels plus estimated health care costs trends of 8.2% in the first year trending to 5% through fiscal 2015.

3 Lease supplement payments to Berean Christian Stores Endeavor, LLC

At June 30, 2009, we had $2.3 million of non-current liabilities for uncertain tax positions. We are not able to provide a reasonable estimate of the timing of future payments related to these obligations.

Off Balance Sheet Items

In connection with the sale of the Berean Christian Bookstores completed in August 2006, we assigned all but one lease to the buyers. During June 2009, the Berean business filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. The Berean assets were subsequently resold under section 363 of the Code. The new owners of the Berean business have negotiated lower lease rates and extended lease terms at certain of the leased locations. We remain a guarantor on these leases, but at the renegotiated rates and to the original term of the leases. The aggregate amount of these guarantees is $6.1 million at June 30, 2009. We had no other material off balance sheet items at June 30, 2009, other than the operating leases and purchase obligations summarized above.

Other Matters

Inflation Certain of our expenses, such as wages and benefits, occupancy costs and equipment repair and replacement, are subject to normal inflationary pressures. Inflation for medical costs can impact both our reserves for self-insured medical plans as well as our reserves for workers' compensation claims. We monitor the inflationary rate and make adjustments to reserves whenever it is deemed necessary. Our ability to manage medical costs inflation is dependent upon our ability to manage claims and purchase insurance coverage to limit the maximum exposure for us.

Foreign Currency Translation Our primary functional currencies used by our non-U.S. subsidiaries are the Euro, British Pound Sterling (Pound), Mexican Peso, and Chinese Yuan. During the current year, the Pound Sterling, Euro, and Peso have experienced decreases in value relative to the U.S. dollar, our reporting currency. Since June 30, 2008 the Euro has depreciated by 11.1%, the Pound has depreciated by 17.2% and the Peso has depreciated 22.2% (all relative to the U.S. dollar). These lower exchange values were used in translating the appropriate non-U.S. subsidiaries balance sheets into U.S. dollars at the end of the current year.

Environmental Matters During 2008, the Company entered into an Administrative Order of Consent with the U.S. Environmental Protection Agency related to the removal of various PCB-contaminated materials and soils at a site where the Company leased a building and conducted operations from 1967-1979.

The Company has initiated litigation against our legacy insurance carriers and is actively involved in negotiations surrounding coverage and cost recovery of amounts spent regarding environmental remediation at this site, however, the amount and timing of any potential recovery cannot currently be estimated. See the notes to our consolidated financials statements for further information regarding this event.

We are party to various other claims and legal proceedings, generally incidental to our business. We do not expect the ultimate disposition of these other matters will have a material adverse effect on our financial statements.

Seasonality We are a diversified business with generally low levels of seasonality, however our fiscal third quarter is typically the period with the lowest level of activity.

Employee Relations The Company has labor agreements with a number of union locals in the United States and a number of European employees belong to European trade unions. We renegotiated four union contracts during 2009, and in each case reached an agreement. A total of two collective bargaining contracts covering approximately 180 employees will expire in 2010. The company maintains good working relations with all of its unions, however, there can be no guarantee that agreements can be reached in future negotiations.

Critical Accounting Policies

The Consolidated Financial Statements include accounts of the Company and all of our subsidiaries. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying Consolidated Financial Statements. Although we believe that materially different amounts would not be reported due to the accounting policies described below, the application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. We have listed a number of accounting policies which we believe to be the most critical.

Collectability of Accounts Receivable Accounts Receivable are reduced by an allowance for amounts that may become uncollectible in the future. Our estimate for the allowance for doubtful accounts related to trade receivables includes evaluation of specific accounts where we have information that the customer may have an inability to meet its financial obligation together with a general provision for unknown but existing doubtful accounts.

Realizability of Inventories Inventories are valued at the lower of cost or market and are reduced by a reserve for excess and potentially obsolete inventories. The Company regularly reviews inventory values on hand using specific aging categories, and records a provision for obsolete and excess inventory based on historical usage and estimated future usage. As actual future demand or market conditions may vary from those projected by management, adjustments to inventory valuations may be required.

Realization of Goodwill - Goodwill and certain indefinite-lived intangible assets are not amortized, but instead are tested for impairment at least annually and more frequently whenever events or changes in circumstances indicate that the fair value of the asset may be less than its carrying amount of the asset. The Company s annual test for impairment is performed using a May 31st measurement date.

We have identified our reporting units for impairment testing as our twelve operating segments, which are aggregated into our five reporting segments as disclosed in Note 18 Industry Segment Information.

The test for impairment is a two step process. The first step compares the carrying amount of the reporting unit to its estimated fair value (Step 1). To the extent that the carrying value of the reporting unit exceeds its estimated fair value, a second step is performed, wherein the reporting unit s carrying value is compared to the implied fair value (Step 2). To the extent that the carrying value exceeds the implied fair value, impairment exists and must be recognized.

As quoted market prices are not available for the Company s reporting units, the fair value of the reporting units is determined using one or both of (1) a discounted cash flow model (income approach); and (2) a market adjusted multiple of earnings and revenues (market approach) where comparable data exists for those reporting units. Both methods use various assumptions that are specific to each individual reporting unit in order to determine the fair value. In addition, the Company compares the estimated aggregate fair value of its reporting units to its overall market capitalization.

Due to the continued deterioration in the U.S. equity and credit markets and industry-wide declines in profitability, the Company s market capitalization decreased below its book value during the third quarter of 2009. After taking into consideration these triggering events, the Company concluded that an interim assessment was required and measured goodwill for impairment as of March 31, 2009. Our interim impairment testing at each reporting unit relied on assumptions surrounding general market conditions, short-term growth rates, a terminal growth rate of 3%, and management forecasts of future cash flows. We also considered historical results including sales growth, operating profits, working capital levels, and tax rates. Fair values are determined primarily by discounting estimated future cash flows at an estimated cost of capital. We selected a weighted average cost of capital of 19.0 percent for three of our reporting units, 17 percent for one of our other reporting units, and 16 percent for our remaining units. Estimated future cash flows are based on a detailed cash flow forecast prepared by the relevant reporting unit. We used standard valuation practices to arrive at a weighted average cost of capital based on market inputs, including treasury bond yields, equity risk premiums, and company-specific risk premiums. Changes in discounted cash flow are inversely proportional to changes in the discount rate. An increase in the weighted average cost of capital of approximately 50 basis points in the analysis of the Standex Electronics reporting unit would result in impairment of a portion of its goodwill. We also noted that an increase in the weighted average cost of capital of approximately 100 basis points on other reporting units would not result in the identification of any impairments.

The Company completed Step 1 of the impairment test and determined that the carrying value of the Associated American Industries (AAI) reporting unit within the Food Service Equipment Group exceeded its fair value. Based on the allocation of the unit s fair value in accordance with Step 2, it was determined that goodwill and trademarks at AAI were impaired. As a result, the company determined that the fair value of the goodwill at AAI was approximately $29 million compared to a carrying value of $47 million resulting in a $17.9 million impairment. In addition, we assessed our intangible assets for impairment. Based upon those assessments, we determined the fair value of a non-amortizing intangible asset included in the AAI reporting unit was impaired, and recognized a $3.4 million impairment related to the carrying value of AAI s trademarks.

The Company updated its assessment of goodwill impairment as of its annual measurement date of May 31, 2009. Our annual impairment testing at each reporting unit relied on assumptions similar to those that existed at March 31. Based on changes to the Company s projected risk premiums and general market conditions, including changes in risk-free rates and our specific company rate, between March 31 and May 31, we selected a weighted average cost of capital of 16.5 percent for three of our reporting units, 15.5 percent for one of our other reporting units, and 14.5 percent for our remaining units. An increase in the weighted average cost of capital of approximately 100 basis points in the analysis of the Standex Electronics reporting unit would result in impairment of a portion of its goodwill. We also noted that an increase in the weighted average cost of capital of approximately 100 basis points on other reporting units would not result in the identification of any impairments. No additional impairments were recorded as a result of this update.

While we believe that our estimates of future cash flows are reasonable, changes in assumptions could significantly affect our valuations and result in impairments in the future. The most significant assumption involved in the Company s determination of fair value is the cash flow projections of each reporting unit. Certain of our reporting units have been significantly influenced by the current global economic downturn, including ADP and Standex Electronics, which had goodwill of $14.9 million and $18.8 million, respectively, as of the 2009 measurement date. ADP has been significantly impacted by the declines in new housing starts and other factors impacting residential housing. Standex Electronics has been affected by the impacts on capital equipment makers and to a lesser extent the automotive industry. For each of these reporting units, management has projected that the operating results will continue to be unfavorably impacted in fiscal 2010 but will gradually begin to return to historic levels of profitability in the years 2011 to 2014. If the effects of the current global economic environment are protracted or the recovery is slower than we have projected estimates of future cash flows for each reporting unit may be insufficient to support the carrying value of the reporting units, requiring the Company to re-assess its conclusions related to fair value and the recoverability of goodwill.

Cost of Employee Benefit Plans We provide a range of benefits to our employees, including pensions and some postretirement benefits. We record expenses relating to these plans based upon various actuarial assumptions such as discount rates, assumed rates of return, compensation increases, turnover rates, and health care cost trends. The expected return on plan assets assumption of 8.65% in the U.S. is based on our expectation of the long-term average rate of return on assets in the pension funds and is reflective of the current and projected asset mix of the funds and considers the historical returns earned on the funds. We have analyzed the rates of return on assets used and determined that these rates are reasonable based on the plans historical performance relative to the overall markets as well as our current expectations for long-term rates of returns for our pension assets. The U.S. discount rate of 7.20% reflects the current rate at which pension liabilities could be effectively settled at the end of the year. The discount rate is determined by matching our expected benefit payments from a stream of AA- or higher bonds available in the marketplace, adjusted to eliminate the effects of call provisions. We review our actuarial assumptions, including

discount rate and expected long-term rate of return on plan assets, on at least an annual basis and make modifications to the assumptions based on current rates and trends when appropriate. Based on information provided by our actuaries and other relevant sources, we believe that our assumptions are reasonable.

The cost of employee benefit plans includes the selection of assumptions noted above. A twenty-five basis point change in the expected return on plan assets assumptions, holding our discount rate and other assumptions constant, would increase or decrease pension expense by approximately $0.5 million per year. A twenty-five basis point basis point change in our discount rate, holding all other assumptions constant, would increase or decrease pension expense by approximately $0.3 million annually. See the Notes to the Consolidated Financial Statements for further information regarding pension plans.

Recently Issued Accounting Pronouncements

In April 2008, the FASB issued FASB Staff Position No. 142-3, Determination of the Useful Life of Intangible Assets , (FSP 142-3). FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, Goodwill and Other Intangible Assets . This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP 142-3 is effective for the Company beginning July 1, 2009. The Company is currently evaluating the impact of adopting FSP 142-3 on its financial statements.

In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, which requires disclosures about fair value of financial instruments for interim periods ending after June 15, 2009. The company does not expect the adoption of this FSP to materially affect our disclosures.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Risk Management

We are exposed to market risks from changes in interest rates, commodity prices and changes in foreign currency exchange. To reduce these risks, we selectively use, from time to time, financial instruments and other proactive management techniques. We have internal policies and procedures that place financial instruments under the direction of the Treasurer and restrict all derivative transactions to those intended for hedging purposes only. The use of financial instruments for trading purposes (except for certain investments in connection with the KEYSOP plan and non-qualified defined contribution plan) or speculation is strictly prohibited. The Company has no majority-owned

subsidiaries that are excluded from the consolidated financial statements. Further, we have no interests in or relationships with any special purpose entities.

Exchange Risk

We are exposed to both transactional risk and translation risk associated with exchange rates. The transactional risk is mitigated, in large part, by natural hedges developed with locally denominated debt service on intercompany accounts. We also mitigate certain of our foreign currency exchange rate risk by entering into forward foreign currency contracts from time to time. The contracts are used as a hedge against anticipated foreign cash flows, such as dividend and loan payments, and are not used for trading or speculative purposes. The fair value of the forward foreign currency exchange contracts is sensitive to changes in foreign currency exchange rates, as an adverse change in foreign currency exchange rates from market rates would decrease the fair value of the contracts. However, any such losses or gains would generally be offset by corresponding gains and losses, respectively, on the related hedged asset or liability. At June 30, 2009 and 2008, the fair value of the Company s open foreign exchange contracts were not material.

Our primary translation risk is with the Euro, British Pound Sterling, and Chinese Yuan. A hypothetical 10% appreciation or depreciation of the value of any these foreign currencies to the U.S. Dollar at June 30, 2009, would not result in a material change in our operations, financial position, or cash flows. We do not hedge our translation risk. As a result, fluctuations in currency exchange rates can affect our stockholders equity.

Interest Rate

The Company s effective rate on variable-rate borrowings under the revolving credit agreement increased from 3.52% at June 30, 2008 to 4.11% at June 30, 2009. Our interest rate exposure is limited primarily to interest rate changes on our variable rate borrowings. From time to time, we will use interest rate swap agreements to modify our exposure to interest rate movements. In July 2008, we entered into a series of swap agreements with one and two year terms effectively converting interest payments on $88.5 million of debt due under our revolving credit agreement from variable rates based on LIBOR to a fixed rate of 4.01% based on the Company s leverage ratio at June 30, 2009. Due to the impact of the swaps, an increase in interest rates would not materially impact our annual interest expense at June 30, 2009.

Concentration of Credit Risk

We have a diversified customer base. As such, the risk associated with concentration of credit risk is inherently minimized. As of June 30, 2009, no one customer accounted for more than 5% of our consolidated outstanding receivables or of our sales.

Commodity Prices

The Company is exposed to fluctuating market prices for all commodities used in its manufacturing processes. Each of our segments is subject to the effects of changing raw material costs caused by the underlying commodity price movements. In general, we do not enter into purchase contracts that extend beyond one operating cycle. While Standex considers our relationship with our suppliers to be good, there can be no assurances that we will not experience any supply shortage.

The ADP, Engineering Technologies, Food Service Equipment and Electronics and Hydraulics Groups are all sensitive to price increases for steel products, other metal commodities and petroleum based products. In the past year, we have experienced price fluctuations for a number of materials including steel, copper wire, other metal commodities, refrigeration components and foam insulation. These materials are some of the key elements in the products manufactured in these segments. Wherever possible, we will implement price increases to offset the impact of changing prices. The ultimate acceptance of these price increases, if implemented, will be impacted by our affected divisions respective competitors and the timing of their price increases.

Item 8. Financial Statements and Supplementary Data

Consolidated Balance Sheets

Standex International Corporation and Subsidiaries

As of June 30 (*in thousands, except share data*)	**2009**	**2008**
ASSETS		
Current assets:		
Cash and cash equivalents	$8,984	$28,657
Accounts receivable, net	81,893	103,055
Inventories	75,634	87,619
Income tax receivables	2,186	983
Prepaid expenses and other current assets	2,730	3,337
Deferred tax asset	13,278	13,032
Total current assets	184,705	236,683
Property, plant, equipment	108,612	116,565
Intangible assets	20,450	27,473
Goodwill	101,722	120,650

Prepaid pension cost	--	1,972
Other non-current assets	18,220	19,691
Total non-current assets	249,004	286,351
Total assets	$433,709	$523,034
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ --	$28,579
Accounts payable	58,802	66,174
Accrued liabilities	36,902	50,286
Current liabilities discontinued operations	3,543	2,701
Total current liabilities	99,247	147,740
Long-term debt - less current portion	94,300	106,086
Deferred income taxes	4,859	23,858
Pension obligations	43,281	7,430
Other non-current liabilities	15,736	14,762
Total non-current liabilities	158,176	152,136
Commitments and Contingencies (Notes 11 and 12)		
Stockholders' equity:		
Common stock, par value $1.50 per share - 60,000,000 shares authorized, 27,984,278 issued, 12,386,821 and 12,296,877 shares outstanding in 2009 and 2008	41,976	41,976
Additional paid-in capital	28,690	27,158
Retained earnings	419,157	433,435
Accumulated other comprehensive loss	(52,591)	(17,531)
Treasury shares (15,597,457 shares in 2009 and 15,687,401 shares in 2008)	(260,946)	(261,880)
Total stockholders' equity	176,286	223,158
Total liabilities and stockholders' equity	$433,709	$523,034

See notes to consolidated financial statements.

Consolidated Statements of Operations

Standex International Corporation and Subsidiaries

For the Years Ended June 30 (in thousands, except per share data)	**2009**	**2008**	**2007**
Net sales	$607,086	$697,541	$621,211
Cost of sales	431,111	495,694	448,407
Gross profit	175,975	201,847	172,804
Selling, general and administrative	140,776	162,328	142,421
Impairment of goodwill and intangible assets	21,339	--	--
Restructuring costs	7,839	590	286
Income from operations	6,021	38,929	30,097
Interest expense	6,532	9,510	9,025
Other, net	(215)	(324)	(1,464)
Total	6,317	9,186	7,561
Income (loss) from continuing operations before income taxes	(296)	29,743	22,536
Provision for income taxes	1,594	10,459	6,611
Income (loss) from continuing operations	(1,890)	19,284	15,925
Income (loss) from discontinued operations	(3,515)	(774)	5,317
Net income (loss)	($5,405)	$18,510	$21,242
Basic earnings per share:			
Income (loss) from continuing operations	($0.15)	$1.57	$1.30
Income (loss) from discontinued operations	(0.29)	(0.06)	0.44
Total	($0.44)	$1.51	$1.74
Diluted earnings per share:			
Income (loss) from continuing operations	($0.15)	$1.55	$1.28
Income (loss) from discontinued operations	(0.29)	(0.06)	0.43
Total	($0.44)	$1.49	$1.71

See notes to consolidated financial statements.

Statements of Consolidated Stockholders' Equity and Comprehensive Income (Loss)

Year End (in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock Shares	Treasury Stock Amount	Total Stockholders Equity
Balance, July 1, 2007	$41,976	$25,572	$415,205	($21,000)	15,782	($261,458)	$200,295
Stock issued for employee stock option and purchase plans, including related income tax benefit		(689)			(186)	3,099	2,410
Stock-based compensation		385					385
Treasury stock acquired					141	(4,092)	(4,092)
Comprehensive income							
Net Income			21,242				21,242
Foreign currency translation adjustment				4,192			4,192
Additional minimum liability, net related income tax benefit				3,275			3,275
Total comprehensive income							28,709
Adjustment to apply FAS 158 (net of tax benefit)				(13,000)			(13,000)
Dividends paid ($.84 per share)			(10,276)				(10,276)
Balance, June 30, 2007	$41,976	$25,268	$426,171	($26,533)	15,737	($262,451)	$204,431
Stock issued for employee stock option and purchase plans, including related income tax benefit		(547)			(89)	1,497	950
Stock-based compensation		2,437					2,437
Treasury stock acquired					40	(926)	(926)
Comprehensive income							
Net Income			18,510				18,510
Foreign currency translation adjustment				4,644			4,644
Change in unrealized pension losses, net of tax				(6,698)			(6,698)
Total comprehensive income							16,456
Adjustment to adopt change in measurement provisions of FAS 158 as of			(928)	11,056			10,128

July 1, 2007							
Dividends paid ($.84 per share)			(10,318)				(10,318)
Balance, June 30, 2008	$41,976	$27,158	$433,435	($17,531)	15,688	($261,880)	$223,158
Stock issued for employee stock option and purchase plans, including related income tax benefit		(1,049)			(113)	1,870	821
Stock-based compensation		2,398					2,398
Treasury stock acquired					65	(1,652)	(1,652)
Stock issued for acquisition		183			(43)	716	899
Comprehensive income							
Net loss			(5,405)				(5,405)
Foreign currency translation adjustment				(10,426)			(10,426)
Change in unrealized pension losses, net of tax				(23,484)			(23,484)
Change in fair value of derivatives, net of tax				(1,150)			(1,150)
Total comprehensive loss							(40,465)
Dividends paid ($.68 per share)			(8,873)				(8,873)
Balance, June 30, 2009	**$41,976**	**$28,690**	**$419,157**	**($52,591)**	**15,597**	**($260,946)**	**$176,286**

See notes to consolidated financial statements.

Statements of Consolidated Cash Flows

Standex International Corporation and Subsidiaries

For the Years Ended June 30 *(in thousands)*	**2009**	**2008**	**2007**
Cash Flows from Operating Activities			
Net income (loss)	($5,405)	$18,510	$21,242
Income (loss) from discontinued operations	(3,515)	(774)	5,317
Income (loss) from continuing operations	(1,890)	19,284	15,925
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	15,541	17,113	15,198
Stock-based compensation	2,398	2,437	385

Deferred income taxes	(3,563)	(467)	(1,133)
Impairment Charges	21,339	--	--
Non-cash portion of restructuring charge	3,730	94	--
(Gain)/loss on sale of investments, real estate and equipment and debt extinguishment	375	(344)	(1,023)
Increase/(decrease) in cash from changes in assets and liabilities,			
net of effects from discontinued operations and business acquisitions:			
Accounts receivables, net	18,360	4,738	(1,591)
Inventories	11,605	4,299	(4,261)
Contributions to defined benefit plans	--	(620)	(3,862)
Prepaid expenses and other	1,001	471	1,277
Accounts payable	(6,034)	(912)	8,378
Accrued payroll, employee benefits and other liabilities	(18,039)	836	1,151
Income taxes payable	(1,550)	(1,746)	2,053
Net cash provided by operating activities - continuing operations	43,273	45,183	32,497
Net cash (used in)/provided by operating activities - discontinued operations	(3,829)	(477)	(7,002)
Net cash provided by operating activities	39,444	44,706	25,495
Cash Flows from Investing Activities			
Expenditures for property, plant and equipment	(5,238)	(9,907)	(10,341)
Expenditures for acquisitions, net of cash acquired	(5,617)	--	(95,444)
Expenditures for executive life insurance policies	(695)	(626)	(642)
Proceeds withdrawn from life insurance policies	3,753	3,129	--
Proceeds from sale of investments, real estate and equipment	639	8,129	1,371
Net cash used for investing activities from continuing operations	(7,158)	725	(105,056)
Net cash provided by investing activities from discontinued operations	--	1,661	31,064
Net cash used for investing activities	(7,158)	2,386	(73,992)
Cash Flows from Financing Activities			
Proceeds from additional borrowings	66,650	150,000	85,305
Payments of debt	(107,311)	(183,624)	(34,282)
Stock issued under employee stock option and purchase plans	821	950	2,168
Excess tax benefit associated with stock option exercises	--	--	242
Debt issuance costs	--	(231)	--
Cash dividends paid	(8,384)	(10,318)	(10,276)
Purchase of treasury stock	(1,652)	(926)	(4,091)
Net cash provided by/(used for) financing activities from continuing operations	(49,876)	(44,149)	39,066
Net cash used for financing activities from discontinued operations	--	--	--
Net cash provided by/(used for) financing activities	(49,876)	(44,149)	39,066
Effect of exchange rate changes on cash	(2,083)	1,657	898

Net changes in cash and cash equivalents	(19,673)	4,600	(8,533)
Cash and cash equivalents at beginning of year	28,657	24,057	32,590
Cash and cash equivalents at end of year	$8,984	$28,657	$ 24,057
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the year for:			
Interest	$6,378	$9,921	$7,815
Income taxes, net of refunds	$5,002	$10,314	$11,884
Capital expenditures included in accounts payable at year end	$ --	$1,082	$ --

See notes to consolidated financial statements.

STANDEX INTERNATIONAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF ACCOUNTING POLICIES

Basis of Presentation and Consolidation

Standex International Corporation (Standex or the Company) is a diversified manufacturing company with operations in the United States, Europe, Asia, and Latin America. The accompanying consolidated financial statements include the accounts of Standex International Corporation and its subsidiaries and are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All intercompany accounts and transactions have been eliminated in consolidation. Where applicable, prior year amounts have been reclassified to conform to current year presentation.

The Company considers events or transactions that occur after the balance sheet date but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. Subsequent events have been evaluated through August 31, 2009, the date of issuance of these financial statements.

Accounting Estimates

The preparation of consolidated financial statements in conformity with GAAP requires the use of estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the financial statements and for the period then ended. Estimates are based on historical experience, actuarial estimates, current conditions and various other assumptions that are believed to be reasonable under the circumstances. These estimates form the basis for making judgments about the carrying values of assets and liabilities when they are not readily apparent from other sources. These estimates assist in the identification and assessment of the accounting treatment necessary with respect to commitments and contingencies. Actual results may differ from these estimates under different assumptions or conditions.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments purchased with a maturity of three months or less. These investments are carried at cost, which approximates fair value. At June 30, 2009 and 2008, the Company s cash was comprised solely of cash on deposit.

Trading Securities

The Company purchases investments in connection with the KEYSOP Plan for certain retired executives and for its non-qualified defined contribution plan for employees who exceed certain thresholds under our traditional 401(k) plan. These investments are classified as trading and reported at fair value. The investments generally consist of mutual funds, are included in other non-current assets and amounted to $4.9 million and $5.2 million at June 30, 2009 and 2008, respectively.

Accounts Receivable Allowances

The changes in the allowances for uncollectible accounts during 2009, 2008 and 2007 were as follows (in thousands):

	2009	**2008**	**2007**
Balance at beginning of year	$3,299	$3,339	$4,976
Provision charged to expense	155	732	970
Businesses sold	--	--	(1,308)
Write-offs, net of recoveries	(818)	(772)	(1,299)
Balance at end of year	$2,636	$3,299	$3,339

Inventories

Inventories are stated at the lower of first-in, first-out cost or market.

Long-Lived Assets

Long-lived assets that are used in operations, excluding goodwill and identifiable intangible assets, are tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. Recognition and measurement of a potential impairment loss is performed on assets grouped with other assets and liabilities at the lowest level where identifiable cash flows are largely independent of the cash flows of other assets and liabilities. An impairment loss is the amount by which the carrying amount of a long-lived asset (asset group) exceeds its estimated fair value. Fair value is determined based on discounted cash flows or appraised values, depending upon the nature of the assets.

Property, Plant and Equipment

Property, plant and equipment are reported at cost less accumulated depreciation. Depreciation is recorded on assets over their estimated useful lives, generally using the straight-line method. Lives for property, plant and equipment are as follows:

Buildings	40 to 50 years
Leasehold improvements	10 to 15 years
Machinery and equipment	8 to 15 years
Furniture and Fixtures	3 to 10 years
Computer hardware and software	3 to 7 years

Routine maintenance costs are expensed as incurred. Major improvements are capitalized. Major improvements to leased buildings are capitalized as leasehold improvements and depreciated over the lesser of the lease term or the life of the improvement.

Goodwill and Identifiable Intangible Assets

All business combinations are accounted for using the purchase method, and goodwill and identifiable, intangible assets with indefinite lives are not amortized, but are reviewed annually for impairment or more frequently if impairment indicators arise. Identifiable intangible assets that are not deemed to have indefinite lives are amortized on an accelerated basis over the following useful lives:

Customer relationships	15 to 16 years
Patents	8.5 to 12 years
Non-compete agreements	2 to 4 years
Other	6.2 to 10 years

See discussion of the Company s assessment of impairment in Note 5 Goodwill, and Note 6 Intangible Assets.

Assets Held for Sale

Assets held for sale are reported at the lower of the assets carrying amount or fair value, less costs to sell. Assets held for sale are included in other non-current assets in the consolidated balance sheet and amounted to $2.9 million and $0.7 million at June 30, 2009 and 2008, respectively, and are comprised of real estate.

Fair Value of Financial Instruments

Our financial instruments, shown below, are presented at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models may be applied.

Assets and liabilities recorded at fair value in our balance sheet are categorized based upon the level of judgment associated with the inputs used to measure their fair values. Hierarchical levels directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities are as follows:

Level 1 Quoted prices in active markets for identical assets and liabilities.

Level 2 Inputs, other than quoted prices in an active market, that are observable either directly or indirectly through correlation with market data.

Level 3 Unobservable inputs based upon the Company s best estimate of what market participants would use in pricing the asset or liability.

The fair values of our financial instruments at June 30, 2009 were (in thousands):

	Total	**Level 1**	**Level 2**	**Level 3**
Financial Assets				
Marketable securities - KEYSOP assets	$ 4,387	$ 4,387	$ --	$ --
Marketable securities - deferred compensation plan	477	477	--	--
Foreign Exchange contracts	25	--	25	--
Financial Liabilities				
Foreign Exchange contracts	$ 296	--	$ 296	--
Interest rate swaps	1,799	--	1,799	--

Concentration of Credit Risk

The Company is subject to credit risk through trade receivables and short-term cash investments. Concentration of risk with respect to trade receivables is minimized because of the diversification of our operations, as well as our large customer base and our geographical dispersion. No individual customer accounts for more than 10% of revenues or accounts receivable in the periods presented.

Short-term cash investments are placed with high credit-quality financial institutions. The Company monitors the amount of credit exposure in any one institution or type of investment instrument.

Revenue Recognition

Product and related service revenue is recognized when evidence of an arrangement exists, the price to the customer is fixed or determinable, the collectability of the invoice is established, and when delivery has occurred. Revenues under certain fixed price contracts are generally recorded when deliveries are made.

Cost of Goods Sold and Selling, General and Administrative Expenses

The Company includes expenses in either cost of goods sold or selling, general and administrative categories based upon the natural classification of the expenses. Cost of goods sold includes expenses associated with the acquisition, inspection, manufacturing and receiving of materials for use in the manufacturing process. These costs include inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs as well as depreciation, amortization, wages, benefits and other costs that are incurred directly or indirectly to support the manufacturing process. Selling, general and administrative includes expenses associated with the distribution of our products, sales effort, administration costs and other costs that are not incurred to support the manufacturing process. The Company records distribution costs associated with the sale of inventory as a component of selling, general and administrative expenses in the Statements of Consolidated Income. These expenses include warehousing costs, outbound freight charges and costs associated with distribution personnel. Our gross profit margins may not be comparable to those of other entities due to different classifications of costs and expenses.

Research and Development

Research and development expenditures are expensed as incurred. Total research and development costs charged to expense were $3.9 million, $4.1 million, and $4.7 million for the years ended June 30, 2009, 2008 and 2007, respectively.

Warranties

The expected cost associated with warranty obligations on our products is recorded when the revenue is recognized. Accrued warranty costs were $4.8 million, $5.0 million, and $3.1 million at June 30, 2009, 2008 and 2007, respectively.

Stock-Based Compensation Plans

Stock options and awards have been issued to officers, other management employees and non-employee directors under our various incentive compensation programs. The stock options generally vest over a three to five-year period and have a maturity of ten years from the issuance date. Restricted stock awards generally vest over a three-year period and generally have a maturity of three years. Compensation expense associated with stock options and awards are recorded based on their grant-date fair values and are generally recognized on a straight-line basis over the vesting period. Compensation cost for an award with a performance condition is based on the probable outcome of that performance condition. The stated vesting period is considered non-substantive for retirement eligible participants.

Accordingly, the Company recognizes any remaining unrecognized compensation expense when a participant achieves retirement eligibility.

Foreign Currency Translation

The functional currency of our non-U.S. operations is generally the local currency. Assets and liabilities of non-U.S. operations are translated into U.S. dollars on a monthly basis using period-end exchange rates. Revenues and expenses of these operations are translated using average exchange rates. The resulting translation adjustment is reported as a component of comprehensive income, in the statements of consolidated stockholders equity and comprehensive income. Gains and losses from foreign currency transactions are included in results of operations and were not material for any period presented.

Derivative Instruments and Hedging Activities

Forward foreign currency exchange contracts are periodically used to limit the impact of currency fluctuations on certain anticipated foreign cash flows, such as foreign purchases of materials, dividends and loan payments from subsidiaries. The Company enters into such contracts for hedging purposes only. The Company does not hold or issue derivative instruments for trading purposes. At June 30, 2009 and 2008, the amount of outstanding forward foreign currency exchange contracts was not material. The Company also uses interest rate swaps to manage exposure to interest rates on the Company s variable rate indebtedness. The Company values the swaps based on contract prices in the derivatives market for similar instruments.

Income Taxes

Deferred assets and liabilities are recorded for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax assets and liabilities are determined based on the differences between the financial statements and the tax bases of assets and liabilities using enacted tax rates. Valuation allowances are provided when the Company does not believe it more likely than not the benefit of identified tax assets will be realized.

The Company provides reserves for potential payments of tax to various tax authorities related to uncertain tax positions and other issues. Prior to July 1, 2007, these reserves were recorded when management determined that it was probable that a loss would be incurred related to these matters and the amount of the loss was reasonably determinable. On July 1, 2007, the Company began to account for uncertain tax positions based on a determination of whether and how much of a tax benefit taken by the Company in its tax filings or positions is more likely than not to be realized following resolution of any potential contingencies present related to the tax benefit, assuming that the matter in question will be raised by the tax authorities. Interest and penalties associated with such uncertain tax

positions are recorded as a component of income tax expense.

Earnings Per Share

	2009	2008	2007
Basic Average Shares Outstanding	12,326	12,291	12,232
Effect of Dilutive Securities Stock Options and Restricted Stock Awards		104	172
Diluted Average Shares Outstanding	12,326	12,395	12,404

Both basic and dilutive income are the same for computing earnings per share. Instruments which were not included in the computation of diluted earnings per share because to do so would have had an anti-dilutive effect, totaled 5,240 shares and 3,190 shares for the years ended June 30, 2008 and 2007, respectively. Options to purchase 106,497 shares and 234,602 restricted shares were not included in the computation of diluted earnings per share for the year ended June 30, 2009, due to the Company s net loss for the period.

Recently Issued Accounting Pronouncements

In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, which requires disclosures about fair value of financial instruments for interim periods ending after June 15, 2009. The company does not expect the adoption of this FSP to materially affect our disclosures.

In April 2008, the FASB issued FASB Staff Position No. 142-3, Determination of the Useful Life of Intangible Assets , (FSP 142-3). FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, Goodwill and Other Intangible Assets . This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP 142-3 is effective for the Company beginning July 1, 2009. The Company is currently evaluating the impact of adopting FSP 142-3 on its financial statements.

2. ACQUISITIONS

In connection with an acquisition in 2003, the Company entered into a lease agreement for its Richmond, Virginia, Engraving Group facility pending the completion of a number of environmental requirements by the former owner. Upon satisfaction of those requirements, as evidenced by the issuance of a certificate by the Virginia Department of Environmental Quality, the Company was required to purchase the land and building for $4.5 million. In May 2009,

the certificate was issued, and the Company paid $3.6 million in cash and issued 42,783 shares of common stock from its treasury shares in order to consummate the purchase. The Company recognized an additional $1.4 million of goodwill related to the completion of the transaction, with the remaining purchase price allocated to the land and building.

In January 2007, the Company completed two acquisitions as part of its growth strategy for the Food Service Equipment segment and to expand its product offerings in that business. The Company acquired substantially all the assets of American Foodservice Company (AFS), an equipment manufacturer with expertise in stainless steel fabrication, millwork and solid surface stonework. AFS enables the Company to capture demand for high-end, custom-fabricated foodservice equipment across a spectrum of new cafeteria and commissary applications in markets including corporate headquarters, healthcare facilities and hospitals, colleges and universities, and casinos and hotels.

Also in January 2007, the Company completed the purchase of all the outstanding stock of Associated American Industries, Inc. (AAI). AAI is a leading provider of hot side food service equipment and has brands with global recognition among customers in the food service market. AAI s APW Wyott brand manufactures primarily counter top products used in cooking, toasting, warming and merchandising food for applications in quick service restaurants, convenience stores, small restaurants and concession areas. In addition to APW Wyott, AAI s brands include Bakers Pride, which provides a wide selection of deck ovens, pizza ovens, conveyor ovens and counter top ranges, griddles and char broilers to meet the needs of the restaurant, pizza, supermarket and convenience store market segments, and BevLes, which produces heated proofer and holding cabinets for the restaurant and baking market segments. The addition of AAI complements the Company s existing hot side business, BKI, while providing it with opportunities to cross market to new customers its existing portfolio of products. This acquisition will also provide the Company a sizeable presence in the hot food preparation, storage and merchandising equipment market.

Both acquisitions were integrated into the Food Service Equipment segment. The total purchase price for the two acquisitions totaled $94.9 million, net of cash acquired.

As part of the acquisition, the Company realized $26.2 million of acquired intangible assets, $14.9 million was assigned to customer relationships with an average useful life of 15 years; $10.3 million was assigned to trademarks with indefinite lives; and $0.4 million was allocated to noncompetition agreements with an average estimated useful life of 2 years. The $47 million in goodwill was assigned to Food Service Equipment Group. The total amount of the goodwill recognized will not be deductible for tax purposes. The results of operations of AAI and AFS have been included in the consolidated statement of income from the dates of the acquisitions.

3. INVENTORIES

Inventories are comprised of (in thousands):

June 30	**2009**	**2008**
Raw materials	$ 36,391	$ 37,839
Work in process	22,616	24,254
Finished goods	16,627	25,526
Total	$ 75,634	$ 87,619

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following (in thousands):

	2009	**2008**
Land, buildings and		
leasehold improvements	$92,817	$95,802
Machinery, equipment and other	150,604	157,694
Total	243,421	253,496
Less accumulated depreciation	134,809	136,931
Property, plant and equipment - net	$108,612	$116,565

Depreciation expense for the years ended June 30, 2009, 2008, and 2007 totaled $12.2 million, $13.2 million, and $11.8 million, respectively.

5. GOODWILL

Goodwill and certain indefinite-lived intangible assets are not amortized, but instead are tested for impairment at least annually and more frequently whenever events or changes in circumstances indicate that the fair value of the asset may be less than its carrying amount of the asset. The Company s annual test for impairment is performed using a May 31st measurement date.

We have identified our reporting units for impairment testing as our twelve operating segments, which are aggregated into our five reporting segments as disclosed in Note 18 Industry Segment Information.

The test for impairment is a two step process. The first step compares the carrying amount of the reporting unit to its estimated fair value (Step 1). To the extent that the carrying value of the reporting unit exceeds its estimated fair value, a second step is performed, wherein the reporting unit s carrying value is compared to the implied fair value (Step 2). To the extent that the carrying value exceeds the implied fair value, impairment exists and must be recognized.

As quoted market prices are not available for the Company s reporting units, the fair value of the reporting units is determined using one or both of (1) a discounted cash flow model (income approach); and (2) a market adjusted multiple of earnings and revenues (market approach) where comparable data exists for those reporting units. Both methods use various assumptions that are specific to each individual reporting unit in order to determine the fair value. In addition, the Company compares the estimated aggregate fair value of its reporting units to its overall market capitalization.

Due to the continued deterioration in the U.S. equity and credit markets and industry-wide declines in profitability, the Company s market capitalization decreased below its book value during the third quarter of 2009. After taking into consideration these triggering events, the Company concluded that an interim assessment was required and measured goodwill for impairment as of March 31, 2009. Our interim impairment testing at each reporting unit relied on assumptions surrounding general market conditions, short-term growth rates, a terminal growth rate of 3%, and management forecasts of future cash flows. We also considered historical results including sales growth, operating profits, working capital levels, and tax rates. Fair values are determined primarily by discounting estimated future cash flows at an estimated cost of capital. We selected a weighted average cost of capital of 19.0 percent for three of our reporting units, 17 percent for one of our other reporting units, and 16 percent for our remaining units. Estimated future cash flows are based on a detailed cash flow forecast prepared by the relevant reporting unit. We used standard valuation practices to arrive at a weighted average cost of capital based on market inputs, including treasury bond yields, equity risk premiums, and company-specific risk premiums. Changes in discounted cash flow are inversely proportional to changes in the discount rate. An increase in the weighted average cost of capital of approximately 50 basis points in the analysis of the Standex Electronics reporting unit would result in impairment of a portion of its goodwill. We also noted that an increase in the weighted average cost of capital of approximately 100 basis points on other reporting units would not result in the identification of any impairments.

The Company completed Step 1 of the impairment test and determined that the carrying value of the Associated American Industries (AAI) reporting unit within the Food Service Equipment Group exceeded its fair value. Based on the allocation of the unit s fair value in accordance with Step 2, it was determined that goodwill and trademarks at AAI were impaired. As a result, the company determined that the fair value of the goodwill at AAI was approximately $29 million compared to a carrying value of $47 million resulting in a $17.9 million impairment. In addition, we assessed our intangible assets for impairment. Based upon those assessments, we determined the fair value of a non-amortizing intangible asset included in the AAI reporting unit was impaired, and recognized a $3.4 million impairment related to the carrying value of AAI s trademarks.

The Company updated its assessment of goodwill impairment as of its annual measurement date of May 31, 2009. Our annual impairment testing at each reporting unit relied on assumptions similar to those that existed at March 31.

Based on changes to the Company s projected risk premiums and general market conditions, including changes in risk-free rates and our specific company rate, between March 31 and May 31, we selected a weighted average cost of capital of 16.5 percent for three of our reporting units, 15.5 percent for one of our other reporting units, and 14.5 percent for our remaining units. An increase in the weighted average cost of capital of approximately 100 basis points in the analysis of the Standex Electronics reporting unit would result in impairment of a portion of its goodwill. We also noted that an increase in the weighted average cost of capital of approximately 100 basis points on other reporting units would not result in the identification of any impairments. No additional impairments were recorded as a result of this update.

While we believe that our estimates of future cash flows are reasonable, changes in assumptions could significantly affect our valuations and result in impairments in the future. The most significant assumption involved in the Company s determination of fair value is the cash flow projections of each reporting unit. Certain of our reporting units have been significantly impacted by the current global economic downturn, including ADP and Standex Electronics. ADP has been significantly impacted by the declines in new housing starts and other factors impacting residential housing. Standex Electronics has been impacted by the impacts on capital equipment makers and to a lesser extent the automotive industry. For each of these reporting units, management has projected that the operating results will continue to be unfavorably impacted in fiscal 2010 but will gradually begin to return to historic levels of profitability in the years 2011 to 2014. If the effects of the current global economic environment are protracted or the recovery is slower than we have projected estimates of future cash flows for each reporting unit may be insufficient to support the carrying value of the reporting units, requiring the Company to re-assess its conclusions related to fair value and the recoverability of goodwill.

Changes to goodwill during the years ended June 30, 2009 and 2008 are as follows (in thousands):

	2009	**2008**
Balance at beginning of year	$120,650	$118,911
Additions	1,557	--
Foreign currency translation	(2,251)	845
Impairment charge	(17,939)	--
Other adjustments	(295)	894
Balance at end of year	$101,722	$120,650

6. INTANGIBLE ASSETS

As discussed in Note 5 - Goodwill, the Company identified trademarks within the AAI operating segment that were impaired and therefore recorded an asset impairment charge of $3.4 million in the Food Service Equipment Group during 2009.

Intangible assets consist of the following (in thousands):

	Customer Relationships	Trademarks	Other	Total
June 30, 2009				
Cost	$21,402	$8,808	$4,409	$34,619
Accumulated amortization	(9,977)	--	(4,192)	(14,169)
Balance, June 30, 2009	$11,425	$8,808	$217	$20,450
June 30, 2008				
Cost	$20,958	$12,200	$5,550	$38,708
Accumulated amortization	(6,725)	--	(4,510)	(11,235)
Balance, June 30, 2008	$14,233	$12,200	$1,040	$27,473

Amortization expense (excluding impairment) for the years ended June 30, 2009, 2008, and 2007 totaled $3.3 million, $3.9 million, and $3.4 million, respectively. At June 30, 2009, aggregate amortization expense is estimated to be $2.5 million in fiscal 2010, $2.0 million in fiscal 2011, $1.6 million in fiscal 2012, $1.2 million in fiscal 2013, and $1.0 million in fiscal 2014.

7. DEBT

Debt is comprised of the following (in thousands):

	2009	2008
Bank credit agreements	$91,000	$88,500
Institutional investors agreements	--	42,857
Other, due 2009-2018 (0.57% effective rate at June 30, 2009)	3,300	3,308
Total	94,300	134,665
Less current portion	--	28,579
Total long-term debt	$94,300	$106,086

Bank Credit Agreements

The Company has in place a five year, $150 million unsecured revolving credit facility (the facility) with seven participating banks which originated in September 2007. The Company also has an optional $75 million accordion feature under the facility. Funds available under the facility may be used for general corporate purposes or to provide financing for acquisitions. Borrowings under the agreement bear interest at a rate equal to LIBOR plus an applicable percentage based on our consolidated leverage ratio, as defined by the agreement. As of June 30, 2009, the effective rate of interest for outstanding borrowings under the facility was 4.11%. The Company is required to pay an annual fee of 0.15% on the maximum credit line. Excluding the accordion feature, the Company had the ability to borrow an additional $59.0 million under the facility at June 31, 2009.

The Company also utilizes two uncommitted money market credit facilities to help manage daily working capital needs. These unsecured facilities, which are renewed annually, provide for a maximum aggregate credit line of $20 million. No amounts were outstanding under these facilities at June 30, 2009 and 2008. At June 30, 2009, and 2008, the Company had standby letters of credit outstanding, primarily for insurance purposes, of $14.3 million and $14.9 million, respectively

Loan Covenants and Repayment Schedule

Our funded debt agreements contain certain customary affirmative and negative covenants, as well as specific financial covenants. The Company s current financial covenants under the facility are as follows:

Interest Coverage Ratio - The Company is required to maintain a ratio of Earnings Before Interest and Taxes (EBIT) to interest expense for the trailing twelve months of at least 3:1. EBIT is defined in the revolving credit facility to specifically exclude extraordinary and other non-recurring items such as non-cash restructuring charges and goodwill impairment. At June 30, 2009, the Company s Interest Coverage Ratio was 4.78:1.

Leverage Ratio - The Company s ratio of funded debt to trailing twelve month EBITDA, defined as EBIT plus Depreciation and Amortization, may not exceed 3.5:1. At June 30, 2009, the Company s Leverage Ratio was 2.02:1.

Consolidated Net Worth The Company is required to maintain a Consolidated Net Worth of at least $163.7 million plus 50% of cumulative net income since the inception of the agreement. Consolidated Net Worth is defined as the Company s net worth as adjusted for unfunded pension liabilities (not to exceed $40 million) and certain foreign exchange gains and losses. At June 30, 2009, the Company s Consolidated Net Worth was $207.4 million, $8.5 million greater than the required amount of $198.9 million.

Debt is due as follows (in thousands):

2010	$ --
2011	--
2012	--
2013	91,000
2014	--
Thereafter	3,300

The carrying value of the facility exceeds its estimated fair value by $6.2 million at June 30, 2009. At June 30, 2008, the Company s debt approximated fair value.

8. ACCRUED EXPENSES

Accrued expenses consist of the following (in thousands):

	2009	**2008**
Payroll and employee benefits	$15,505	$25,073
Workers' compensation	5,408	7,213
Other	15,989	18,000
Total	$36,902	$50,286

9. DERIVATIVE FINANCIAL INSTRUMENTS

In July 2008, the Company entered into a series of interest rate swap agreements designed to manage exposure to interest rates on the Company s variable rate indebtedness. The Company recognizes all derivatives on its balance sheet at fair value. The Company has designated the swaps as cash flow hedges, and changes in the fair value of the swaps are recognized in other comprehensive income until the hedged items are recognized in earnings. Hedge

ineffectiveness, if any, associated with the swaps will be reported by the Company in interest expense.

The swap agreements convert interest payments on $88.5 million of debt due under our revolving credit agreement from variable rates based on LIBOR to a weighted average fixed rate of 4.01% based on the Company s credit spread at June 30, 2009. The fair value of the swaps recognized in accrued expenses and in other comprehensive income at June 30, 2009 is as follows:

Effective Date	Notional Amount	Fixed Interest Rate	Maturity	Fair Value at June 30, 2009
July 14, 2008	10,000,000	2.92%	July 14, 2009	(22)
July 10, 2008	18,500,000	2.95%	July 10, 2009	(42)
July 14, 2008	30,000,000	3.35%	July 14, 2010	(864)
July 10, 2008	30,000,000	3.38%	July 10, 2010	(871)
				(1,799)

The Company reported no losses for the year ended June 30, 2009, as a result of hedge ineffectiveness. Future changes in these swap arrangements, including termination of the agreements, may result in a reclassification of any gain or loss reported in accumulated other comprehensive income into earnings as an adjustment to interest expense. Because the swaps mature over the next fiscal year, the entire balance recognized in accumulated other comprehensive income at June 30, 2009 is expected to be recognized in the next twelve months.

10. INCOME TAXES

The components of income from continuing operations before income taxes are as follows (in thousands):

	2009	2008	2007
U.S. Operations	($8,781)	$14,627	$11,942
Non-U.S. Operations	8,485	15,116	10,594
Total	($296)	$29,743	$22,536

The Company utilizes the asset and liability method of accounting for income taxes. Deferred income taxes are determined based on the estimated future tax effects of differences between the financial and tax bases of assets and liabilities given the provisions of the enacted tax laws. The components of the provision for income taxes on continuing operations (in thousands) were as shown below:

	2009	2008	2007
Current:			
Federal	$2,358	$5,805	$4,882
State	778	1,150	751
Non-U.S.	2,021	3,971	2,111
Total Current	5,157	10,926	7,744
Deferred:			
Federal	($2,777)	($125)	($843)
State	(714)	(637)	(728)
Non-U.S.	(72)	295	438
Total Deferred	(3,563)	(467)	(1,133)
Total	$1,594	$10,459	$6,611

A reconciliation from the U.S. Federal income tax rate on continuing operations to the total tax provision is as follows (in thousands):

	2009	2008	2007
Provision at statutory tax rate	(102)	10,409	7,888
State taxes	259	334	15
Foreign rate differential	(887)	(782)	(659)
Impact of foreign repatriation	-	407	1,324
Change in US tax classification	(1,812)	-	-
Impairment of goodwill	6,099	-	-
Federal tax credits	(992)	(247)	(1,320)
Other	(971)	338	(637)
Effective income tax provision	1,594	10,459	6,611

Changes in the effective tax rates from period to period may be significant as they depend on many factors including, but not limited to, size of the Company s income or loss and any one-time activities occurring during the period.

The Company s income tax provision from continuing operations for the fiscal year ended June 30, 2009 was significantly impacted by the following items (i) a benefit of $0.8 million from the reversal of income tax contingency reserves that were determined to be no longer needed due to the expiration of applicable limitation statutes, (ii) the $21.3 million impairment for which only $1.3 million of tax benefit could be realized as the goodwill had no tax basis, (iii) a benefit totaling $1.7 million from the reversal of the deferred tax liability that was no longer required due to a change in the U.S. tax classification of one of our foreign entities, (iv) a benefit of $0.6 million related primarily to the retroactive extension of the R&D credit recorded during the second quarter and (v) a benefit related to the receipt of $1.1 million of nontaxable life insurance proceeds during the first quarter and other minor adjustments.

Significant components of the Company s deferred income taxes are as follows (in thousands):

	2009	2008
Deferred tax liabilities:		
Depreciation and amortization	$ (27,163)	$ (28,476)
Deferred tax assets:		
Accrued compensation	3,270	3,257
Accrued expenses and reserves	10,273	7,210
Pension	15,054	699
Inventory	1,879	1,800
Other	1,356	1,309
Net operating loss and credit carry forwards	4,601	5,385
Total deferred tax asset	36,433	19,660
Less: Valuation allowance	(851)	(2,010)
Net deferred tax asset (liability)	$ 8,419	$ (10,826)

The Company estimates the degree to which deferred tax assets, including net operating loss and credit carry forwards will result in a benefit based on expected profitability by tax jurisdiction and provides a valuation allowance for tax assets and loss carry forwards that it believes will more likely than not go unrealized. The valuation allowances at June 30, 2009 applies to the tax benefit of foreign loss carry forwards, which management has concluded that it is more likely than not that these tax benefits will not be realized. The increase (decrease) in the valuation allowance totaled ($1.2 million), $0.4 million, and $0.4 million in 2009, 2008, and 2007, respectively.

As of June 30, 2009, the Company had state net operating loss ("NOL") and credit carry forwards of approximately $21.0 million and $0.9 million, respectively, which may be available to offset future state income tax liabilities and expire at various dates from 2010 through 2029. In addition, the Company had foreign NOL carry forwards of approximately $6.9 million, $6.8 million of which carry forward indefinitely and $0.1 million that carry forward for 5 years.

The Company s income taxes currently payable for federal and state purposes have been reduced by the benefit of the tax deduction in excess of recognized compensation cost from employee stock compensation transactions. The provision for income taxes that is currently payable does not reflect approximately $0.1 million and $0 of such benefits of the Company that have been allocated to capital in excess of par value in 2009 and 2008, respectively.

A provision has not been made for U.S. or additional non-U.S. taxes on $32.7 million of undistributed earnings of international subsidiaries that could be subject to taxation if remitted to the U.S. because the Company plans to keep these amounts permanently reinvested overseas except for instances where the Company can remit such earnings to the U.S. without an associated net tax cost.

The total provision for income taxes included in the consolidated financial statements was as follows (in thousands):

	2009	**2008**	**2007**
Continuing operations	$1,594	$10,459	$6,611
Discontinued operations	(2,100)	(477)	3,330
	($506)	$9,982	$9,941

The changes in the amount of gross unrecognized tax benefits during 2009 were as follows (in thousands):

	2009	**2008**
Beginning Balance	$3,196	$2,830
Additions based on tax positions related to the current year	745	439
Additions for tax positions of prior years	--	--
Reductions for tax positions of prior years	(690)	(73)
Settlements	(905)	--
Ending Balance	2,346	3,196

If these tax benefits were recognized in a future period, the entire amount of unrecognized tax benefit would impact the Company s effective tax rate.

The Company and its subsidiaries are subject to U.S. Federal income tax as well as the income tax of multiple state and non-U.S. jurisdictions. During 2009, the Company concluded a tax examination with the IRS for the years ended June 30, 2004 and June 30, 2005. Settlements during the year were fully reserved for and did not result in additional expense.

Within the next twelve months, the statute of limitations will close in various U.S., state and non-U.S. jurisdictions. As a result, it is reasonably expected that net unrecognized tax benefits from these various jurisdictions would be recognized within the next twelve months. The recognition of these tax benefits is not expected to have a material impact to the Company's financial statements. The Company does not reasonably expect any other significant changes in the next twelve months. The following tax years, in the major tax jurisdictions noted, are open for assessment or refund:

Country

_

Years Ending June 30,

United States

2006 to 2009

Canada

2006 to 2009

Ireland

2006 to 2009

Portugal

2006 to 2009

United Kingdom

2008 to 2009

The Company s policy is to include interest expense and penalties related to unrecognized tax benefits within the provision for income taxes on the consolidated statements of operations. At June 30, 2009 and June 30, 2008, the Company had approximately $0.2 million and $0.7 million, respectively, accrued for interest expense on unrecognized tax benefits.

11. COMMITMENTS

The Company leases certain property and equipment under agreements with initial terms ranging from one to twenty years. Rental expense for the years ended June 30, 2009, 2008 and 2007 was approximately $4.8 million, $5.5 million, and $4.6 million, respectively. At June 30, 2009, the minimum annual rental commitments under noncancelable operating leases, principally real estate, were approximately $4.8 million in 2010, $3.3 million in 2011, $2.4 million in 2012, $1.7 million in 2013, $1.1 million in 2014, and $2.8 million thereafter.

In September 2007, Standex Air Distribution Products, Inc. (ADP), a subsidiary of the Company, sold its manufacturing facility located in Philadelphia and leased back approximately two-thirds of the floor space of the facility. The lease has an initial term of ten years with two consecutive additional five-year options to renew. The net proceeds from the sale, after transaction and other related costs, were $7.2 million resulting in a gain of approximately $2.3 million which was deferred and is being recognized in proportion to the lease payments expensed over the initial 10-year lease term. The deferred gain is classified as other non-current liabilities on the balance sheet.

The Company is a guarantor of certain assigned leases to Berean Christian Bookstores (Berean), an operation disposed of by the Company in 2006. As the former owner of Berean, the Company is party under a number of operating leases which were assigned to the purchaser of the business for the remaining initial terms of the leases at the stated lease costs. The Company remained the guarantor of these leases until the expiration of the initial terms. In the second quarter of 2009, noting Berean s deteriorating operating performance and precarious financial position, the Company recorded liabilities of $2.9 million, net of estimated subleases, in anticipation of the impairment of leases remaining under the obligation.

In June 2009, Berean filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code and, in July 2009, its assets were sold to a third party under Section 363 of the Code. As part of this transaction, the Company agreed to provide lease supplement payments to the new owner of the Berean assets. These payments included an upfront payment of $0.5 million and additional payments totaling $1.2 million which will be made in equal monthly installments through December 2011. The Company will remain a guarantor of the leases assumed by the new owner, however, our guarantee has been reduced for locations where the new owner was able to obtain rent concessions. In addition, the Company remains a guarantor of three sites formerly operated by Berean. Liabilities associated with these three guarantees, net of expected subleases, total $1.1 million at June 30, 2009. Subsequent to these transactions, the total amount of remaining lease payments guaranteed by the company was $6.1 million.

12. CONTINGENCIES

The Company is a party to a number of actions filed or has been given notice of potential claims and legal proceedings related to environmental, commercial disputes, employment matters and other matters generally incidental to our business. Liabilities are recorded when the amount can be reasonably estimated and the loss is deemed probable. Management has evaluated each matter based, in part, upon the advice of our independent environmental consultants and in-house personnel. Management believes the ultimate resolution will not be material to our financial position, results of operations or cash flows.

During 2008, the Company entered into an Administrative Order of Consent with the U.S. Environmental Protection Agency (EPA) related to the removal of various PCB-contaminated materials and soils at a site where the Company leased a building and conducted operations from 1967-1979. The Company established an accrual of $2.0 million related to the matter in 2008 and an additional $2.0 million in 2009. Remediation efforts were substantially completed during the 3rd quarter of 2009, and the Company anticipates receiving a closing letter from the EPA in the first half of 2010.

As the site is the former location of the Club Products and Monarch Aluminum divisions, the charge has been included in results from discontinued operations for the period. The Company has initiated litigation against our legacy insurance carriers and is actively involved in negotiations surrounding coverage and cost recovery of amounts spent regarding environmental remediation at this site, however, the amount and timing of any potential recovery cannot currently be estimated and no recovery has been recognized through June 30, 2009.

The Company has updated its environmental study relating to certain land and buildings in France that was originally completed in the second quarter of fiscal 2006. The study was updated due to a change in environmental regulations and in anticipation of marketing the property for sale. Until a use for the property is determined, no remediation work plans will be required by local regulators. The Company has recorded $0.3 million as of June 30, 2009 for the estimated costs associated with this property.

13. STOCK-BASED COMPENSATION AND PURCHASE PLANS

Stock-Based Compensation Plans

Under incentive compensation plans, the Company is authorized to make grants of stock options, restricted stock and performance share units to provide equity incentive compensation to key employees and directors. In fiscal 2004, the Company began granting stock awards instead of stock options. The stock award program offers employees and directors the opportunity to earn shares of our stock over time, rather than options that give the employees and directors the right to purchase stock at a set price. The Company has stock plans for directors, officers and certain key employees.

Total compensation cost recognized in income for equity based compensation awards was $2.4 million, $2.4 million, and $0.4 million for the years ended June 30, 2009, 2008 and 2007, respectively. The total income tax benefit recognized in the consolidated income statement for equity-based compensation plans was $0.8 million, $0.9 million, and $0.1 million for the years ended June 30, 2009, 2008 and 2007, respectively.

At June 30, 2009, 634,144 shares of common stock were reserved for issuance under various compensation plans.

Restricted Stock Awards

The Company may award shares of restricted stock to eligible employees and non-employee directors of the Company at no cost, giving them in most instances all of the rights of stockholders, except that they may not sell, assign, pledge or otherwise encumber such shares and rights during the restriction period. Such shares and rights are subject to forfeiture if certain employment conditions are not met. During the restriction period, recipients of the shares are entitled to dividend equivalents on such shares, providing that such shares are not forfeited. Dividends are accumulated and paid out at the end of the restriction period. During 2009, 2008 and 2007 the Company granted 64,091, 70,351, and 41,270 shares, respectively, of restricted stock to eligible participants. Restrictions on the stock awards lapse between fiscal 2010 and fiscal 2012, with the exception of one award which vests upon the employee s retirement. For the years ended June 30, 2009, 2008 and 2007, $1.4 million, $1.1 million and $1.3 million, respectively, was recognized as compensation expense related to restricted stock awards. Substantially all awards are expected to vest.

A summary of stock options and restricted stock awards activity during the year ended June 30, 2009 is as follows:

	Stock Options			Restricted Stock Awards	
	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Shares	Aggregate Intrinsic Value
Outstanding, July 1, 2008	29,760	$20.05	$24,000	144,072	$2,988,000
Granted	--	--		64,091	
Exercised / vested	(22,700)	20.09	166,425	(30,511)	695,423
Canceled	--	--		(3,050)	
Outstanding, June 30, 2009	7,060	$19.90	--	174,602	$1,561,383

At June 30, 2009, all 7,060 outstanding stock options were exercisable and have a weighted-average remaining contractual life of 3.25 years.

Restricted stock awards granted during 2009, 2008 and 2007 had a weighted average grant date fair value of $24.19, $22.63, and $28.05, respectively. The grant date fair value of restricted stock awards is determined based on the closing price of the Company s common stock on the date of grant. The total intrinsic value of options and awards exercised during the years ended June 30, 2009, 2008 and 2007 was $0.9 million, $0.9 million, and $1.4 million, respectively.

As of June 30, 2009, there was $2.0 million of unrecognized compensation costs related to stock options and awards expected to be recognized over a weighted-average period of 1.25 years.

Executive Compensation Program

The Company operates a compensation program for key employees. The plan contains both an annual component as well as long-term component. Under the annual component, participants are required to defer 20% (and may elect to defer up to 50%) of their annual incentive compensation in restricted stock which is purchased at a discount to the market. Additionally, non-employee directors of the Company may defer a portion of their director s fees in restricted stock units which is purchased at a discount to the market. During the restriction period, recipients of the shares are entitled to dividend equivalents on such units, providing that such shares are not forfeited. Dividend equivalents are accumulated and paid out at the end of the restriction period. The restrictions on the units expire after three years. At June 30, 2009 and 2008, respectively, 99,437 and 70,848 shares of restricted stock units are outstanding and subject to restrictions that lapse between fiscal 2010 and fiscal 2012. The compensation expense associated with this incentive program is charged to income over the restriction period. The Company recorded compensation expense related to this program of $0.4 million, $0.2 million, $0.3 million for the years ended June 30, 2009, 2008 and 2007, respectively.

The fair value of the awards under the annual component of this incentive program is measured using the Black-Scholes option-pricing model. Key assumptions used to apply this pricing model are as follows:

	2009	2008	2007
Range of risk-free interest rates	2.45%	4.11%	4.59 4.77%
Range of expected life of option grants (in years)	3	3	3
Expected volatility of underlying stock	44.5%	34.9%	32.0%
Expected quarterly dividends (per share)	$0.21	$0.21	$0.21

Under the long-term component, grants of performance share units (PSUs) are made annually to key employees and the share units are earned based on the achievement of certain overall corporate financial performance targets over the performance period. At the end of the performance period, the number of shares of common stock issued will be determined by adjusting upward or downward from the target in a range between 10% and 200%. No shares will be issued if the minimum performance threshold is not achieved. The final performance percentage, on which the payout will be based, considering the performance metrics established for the performance period, will be determined by the Compensation Committee of the Board of Directors.

The awards granted by the Committee on August 28, 2008 and August 28, 2007 provided that the PSUs will be converted to shares of common stock if the Company s EBITDA (earnings before interest, taxes, depreciation and amortization) and return on assets meet specified levels approved by the Committee. A participant s right to any shares that are earned will vest in three equal installments. An executive whose employment terminates prior to the vesting of any installment for a reason other than death, disability, retirement, or following a change in control, will forfeit the shares represented by that installment. In certain circumstances, such as retirement or a change in control, vesting of the awards granted is accelerated and PSU s are paid on a pro-rata basis.

In fiscal 2007, the PSU grants would have been earned based on achievement of performance targets over a three-year period. These awards would have cliff vested after performance targets were achieved at the end of the three-year period, and shares of common stock would have been issued following the end of the performance period.

A summary of the awards activity under the executive compensation program during the year ended June 30, 2009 is as follows:

	Annual Component			Performance Stock Units	
	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Shares	Aggregate Intrinsic Value
Non-vested, July 1, 2008	70,848	$19.26	$130,000	88,222	$1,830,000
Granted	47,499	15.56		58,800	
Vested	(18,910)	20.22	155,440	(30,000)	1,377,684
Expired	--	--		(87,022)	
Non-vested, June 30, 2009	99,437	$17.31	--	30,000	$348,000

Restricted stock awards granted under the annual component of this program in fiscal 2009, 2008 and 2007 had a grant date fair value of $28.98, $23.54, and $31.32, respectively. The PSU s granted in fiscal 2009, 2008 and 2007 had a grant date fair value of $23.43, $24.20, and $29.23, respectively. The total intrinsic value of awards vested under the executive compensation program during the years ended June 30, 2009, 2008 and 2007 was $1.5 million, $0.7 million, and $0.3 million, respectively. During 2009, 58,800 and 28,222 performance stock units awarded during the years ended June 30, 2009 and June 30, 2007, respectively, expired without meeting performance targets.

The Company recognized compensation expense related to the PSU s of $0.7 million, $1.2 million, and $0 for the years ended June 30, 2009, 2008 and 2007, respectively. The total unrecognized compensation costs related to non-vested performance share units was $0.3 million at June 30, 2009 which is expected to be recognized over a weighted average period of 1.0 year.

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan that allows employees to purchase shares of common stock of the Company at a discount from the market each quarter. Shares of our stock may be purchased by employees quarterly at 95% of the fair market value on the last day of each quarter. Shares of stock reserved for the plan were 147,195 at June 30, 2009. Shares purchased under this plan aggregated 30,634, 27,808, and 23,878 in 2009, 2008 and

2007, respectively at an average price of $14.12, $19.06, and $25.91 respectively.

14. ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of accumulated other comprehensive loss are as follows (in thousands):

June 30	**2009**	**2008**
Foreign currency translation adjustment	$ 8,902	$ 19,328
Unrealized pension losses (net of tax benefit of $36.1 million and $21.4 million, respectively)	(60,343)	(36,859)
Unrealized loss on derivative instruments (net of tax benefit of $0.6 million)	(1,150)	--
Accumulated other comprehensive loss	$ (52,591)	$ (17,531)

15. DISCONTINUED OPERATIONS AND DISPOSITIONS

In 2007, the Company sold substantially all the assets of the Berean Christian Stores (Berean) business in an all cash deal resulting in the recognition of a pre-tax gain of $0.2 million. As the former owner of Berean, the Company is party under a number of operating leases which were assigned to the purchaser of the business for the remaining initial terms of the leases at the stated lease costs. The Company remained the guarantor of these leases until the expiration of the initial terms. In the second quarter of 2009, noting Berean s deteriorating operating performance and precarious financial position, the Company recorded liabilities of $2.9 million, net of estimated subleases, in anticipation of the impairment of leases remaining under the obligation.

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Derivatives - current

6

4

40

—

Derivatives - noncurrent	30	26	4	—
Total fair value of derivatives	$ 51,836	$ 122,547	$ 39,245	$ 57,874

14

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Offsetting of Derivatives

The Company transacts under master netting arrangements or equivalent agreements that allow it to offset derivative assets and liabilities with the same counterparty. However, the Company's policy is to present its derivative assets and liabilities on a gross basis at the contract level unit of account on the Unaudited Condensed Consolidated Balance Sheets.

The following table summarizes the reported gross amounts, the amounts that the Company has the right to offset but elects not to, financial collateral, as well as the net amounts the Company could present on the Unaudited Condensed Consolidated Balance Sheets but elects not to.

(Thousands)	Amounts Presented on Balance Sheets [1]	Offsetting Derivative Instruments [2]	Financial Collateral Received/Pledged [3]	Net Amounts [4]
As of December 31, 2017:				
Derivative assets:				
Energy Services				
Physical commodity contracts	$16,048	$(3,137)	$ (200)	$12,711
Financial commodity contracts	35,265	(29,434)	(5,327)	504
Foreign currency contracts	36	(30)	—	6
Total Energy Services	$51,349	$(32,601)	$ (5,527)	$13,221
Natural Gas Distribution				
Physical commodity contracts	$487	$(25)	$ —	$462
Total Natural Gas Distribution	$487	$(25)	$ —	$462
Derivative liabilities:				
Energy Services				
Physical commodity contracts	$38,787	$(3,137)	$ —	$35,650
Financial commodity contracts	67,665	(29,434)	(38,231)	—
Foreign currency contracts	30	(30)	—	—
Total Energy Services	$106,482	$(32,601)	$ (38,231)	$35,650
Natural Gas Distribution				
Physical commodity contracts	$53	$(25)	$ —	$28
Financial commodity contracts	3,478	—	(3,478)	—
Interest rate contracts	12,534	—	—	12,534
Total Natural Gas Distribution	$16,065	$(25)	$ (3,478)	$12,562
As of September 30, 2017:				
Derivative assets:				
Energy Services				
Physical commodity contracts	$21,715	$(2,173)	$ (200)	$19,342
Financial commodity contracts	17,335	(14,121)	—	3,214
Foreign currency contracts	44	—	—	44
Total Energy Services	$39,094	$(16,294)	$ (200)	$22,600
Natural Gas Distribution				

Physical commodity contracts	$151	$(20)	$ —	$131
Total Natural Gas Distribution	$151	$(20)	$ —	$131
Derivative liabilities:				
Energy Services				
Physical commodity contracts	$25,299	$(2,173)	$ —	$23,126
Financial commodity contracts	22,887	(14,121)	(8,766)	—
Total Energy Services	$48,186	$(16,294)	$ (8,766)	$23,126
Natural Gas Distribution				
Physical commodity contracts	$72	$(20)	$ —	$52
Financial commodity contracts	1,149	—	(1,149)	—
Interest rate contracts	8,467	—	—	8,467
Total Natural Gas Distribution	$9,688	$(20)	$ (1,149)	$8,519

(1) Derivative assets and liabilities are presented on a gross basis on the balance sheet as the Company does not elect balance sheet offsetting under ASC 210-20.

(2) Includes transactions with NAESB netting election, transactions held by FCMs with net margining and transactions with ISDA netting.

(3) Financial collateral includes cash balances at FCMs as well as cash received from or pledged to other counterparties.

(4) Net amounts represent presentation of derivative assets and liabilities if the Company were to elect balance sheet offsetting under ASC 210-20.

15

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Energy Services utilizes financial derivatives to economically hedge the gross margin associated with the purchase of physical gas to be used for storage injection and its subsequent sale 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 delivered. 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 Energy Services, 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:		2017	2016
Energy Services:			
Physical commodity contracts	Operating revenues	$1,210	$1,743
Physical commodity contracts	Gas purchases	(22,697)	(8,799)
Financial commodity contracts	Gas purchases	(25,997)	(30,611)
Foreign currency contracts	Gas purchases	(48)	(86)
Total unrealized and realized gains (losses)		$(47,532)	$(37,753)

NJNG's derivative contracts are part of the Company's risk management activities that relate to its natural gas purchases, BGSS incentive programs and debt financing. These transactions are entered into pursuant to regulatory approval. At settlement, the resulting gains and/or losses are payable to or recoverable from utility customers and are deferred in regulatory assets or liabilities resulting in no impact to earnings. The following table reflects the (losses) gains associated with NJNG's derivative instruments as of:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Natural Gas Distribution:		
Physical commodity contracts	$(2,976)	$1,050
Financial commodity contracts	(8,808)	11,178
Interest rate contracts	(4,067)	20,371
Total unrealized and realized (losses) gains	$(15,851)	$32,599

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

	Volume (Bcf)	
	December 31, 2017	September 30, 2017

Natural Gas Distribution	Futures	20.4	18.2
	Physical	26.8	32.1
Energy Services	Futures	(33.4)	(16.4)
	Physical	(4.6)	(13.1)

Not included in the previous table are Energy Services' gross notional amount of foreign currency transactions of approximately $9.7 million, NJNG’s treasury lock agreement as previously discussed and 403,000 SRECs at Energy Services that are open as of December 31, 2017.

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Broker Margin

Futures exchanges have contract specific margin requirements that require the posting of cash or cash equivalents relating to traded contracts. Margin requirements consist of initial margin that is posted upon the initiation of a position, maintenance margin that is usually expressed as a percent of initial margin, and variation margin that fluctuates based on the daily marked-to-market relative to maintenance margin requirements. The Company maintains separate broker margin accounts for the Natural Gas Distribution and Energy Services segments. The balances are as follows:

(Thousands)	Balance Sheet Location	December 31, 2017	September 30, 2017
Natural Gas Distribution	Broker margin - Current assets	$ 4,632	$ 2,661
Energy Services	Broker margin - Current assets	$ 48,218	$ 23,166

Wholesale Credit Risk

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

NJR monitors and manages the credit risk of its wholesale 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 ISDA and the 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.

Internally-rated exposure applies to counterparties that are not rated by S&P or Moody's. In these cases, the counterparty'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 following is a summary of gross credit exposures grouped by investment and noninvestment grade counterparties, as of December 31, 2017. 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 and Clean Energy Ventures residential solar installations.

(Thousands)	Gross Credit Exposure
Investment grade	$182,514
Noninvestment grade	25,079
Internally rated investment grade	25,435
Internally rated noninvestment grade	61,714
Total	$294,742

Conversely, certain of NJNG's and Energy Services' 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, 2017 and September 30, 2017, was $14 million and $8.7 million, respectively, for which the Company had not posted collateral. If all thresholds related to the credit-risk-related contingent features underlying these agreements had been invoked on December 31, 2017 and September 30, 2017, the Company would have been required to post an additional $13.1 million and $8.6 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, as previously discussed.

5. FAIR VALUE

Fair Value of Assets and Liabilities

The fair value of cash and cash equivalents, accounts receivable, current loan receivables, accounts payable, commercial paper and borrowings under revolving credit facilities are estimated to equal their carrying amounts due to the short maturity of those instruments. Non-current loan receivables are recorded based on what the Company expects to receive, which approximates fair value. The Company regularly evaluates the credit quality and collection profile of its customers to approximate fair value.

The estimated fair value of long-term debt at NJNG and NJR, including current maturities, excluding capital leases, debt issuance costs and solar asset financing obligations, is as follows:

(Thousands)	December 31, 2017	September 30, 2017
Carrying value (1) (2) (3)	$ 1,097,045	$ 1,097,045
Fair market value	$ 1,111,265	$ 1,107,676

(1) Excludes capital leases of $45 million and $39.7 million as of December 31, 2017 and September 30, 2017, respectively.

(2) Excludes NJNG's debt issuance costs of $6.2 million and $6.3 million as of December 31, 2017 and September 30, 2017, respectively.

(3) Excludes NJR's debt issuance costs of $804,000 and $770,000 as of December 31, 2017 and September 30, 2017, respectively.

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 maturity of the specific issue and the Company's credit rating. As of December 31, 2017, 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 natural gas futures and options contracts, listed equities and money market funds. Exchange traded futures and options contracts include all energy contracts traded on the NYMEX, CME and ICE that NJR refers internally to as basis swaps, fixed swaps, futures and financial options that are cleared through a FCM.
Level 2	Other significant observable inputs such as interest rates or price data, including both commodity and basis pricing 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, SREC forward sales 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). NJNG's treasury lock is also considered Level 2 as valuation is based on quoted market interest and swap rates as inputs to the valuation model. Inputs are verifiable and do not require significant management judgment. 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 were considered to be a “model,” it would still be considered to be a Level 2 input as the data is:

- widely accepted and public;

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

- non-proprietary and sourced from an independent third party; and
- 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.

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, 2017:				
Assets:				
Physical commodity contracts	$—	$ 16,535	$ —	$16,535
Financial commodity contracts	35,265	—	—	35,265
Financial commodity contracts - foreign exchange	—	36	—	36
Available for sale equity securities - energy industry	55,995	—	—	55,995
Other [1]	1,106	—	—	1,106
Total assets at fair value	$92,366	$ 16,571	$ —	$108,937
Liabilities:				
Physical commodity contracts	$—	$ 38,840	$ —	$38,840
Financial commodity contracts	71,143	—	—	71,143
Financial commodity contracts - foreign exchange	—	30	—	30
Interest rate contracts	—	12,534	—	12,534
Total liabilities at fair value	$71,143	$ 51,404	$ —	$122,547
As of September 30, 2017:				
Assets:				
Physical commodity contracts	$—	$ 21,866	$ —	$21,866
Financial commodity contracts	17,335			17,335
Financial commodity contracts - foreign exchange	—	44	—	44
Available for sale equity securities - energy industry	65,752	—	—	65,752
Other [1]	1,202	—	—	1,202
Total assets at fair value	$84,289	$ 21,910	$ —	$106,199
Liabilities:				
Physical commodity contracts	$—	$ 25,371	$ —	$25,371
Financial commodity contracts	24,036	—	—	24,036
Interest rate contracts	—	8,467	—	8,467

Total liabilities at fair value	$24,036	$33,838	$ —	$57,874

(1) Includes money market funds of $4,000 and $112,000 as of December 31, 2017 and September 30, 2017, respectively.

6. INVESTMENTS IN EQUITY INVESTEES

NJR's investments in equity method investees include the following as of:

(Thousands)	December 31, 2017	September 30, 2017
Steckman Ridge [1]	$ 119,433	$ 120,262
PennEast	59,996	52,323
Total	$ 179,429	$ 172,585

(1) Includes loans with a total outstanding principal balance of $70.4 million for both December 31, 2017 and September 30, 2017. The loans accrue interest at a variable rate that resets quarterly and are due October 1, 2023.

The Company, through its subsidiary NJR Pipeline Company, is an investor in PennEast, which is expected to construct and operate a 120-mile pipeline that will extend from northeast Pennsylvania to western New Jersey and is estimated to be completed and operational in 2019.

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

NJNG and Energy Services have entered into storage and park and loan agreements with Steckman Ridge. In addition, NJNG has entered into a precedent capacity agreement with PennEast. See Note 14. Related Party Transactions for more information on these intercompany transactions.

7. EARNINGS PER SHARE

The following table presents the calculation of the Company's basic and diluted earnings per share for:

	Three Months Ended December 31,	
(Thousands, except per share amounts)	2017	2016
Net income, as reported	$123,699	$34,929
Basic earnings per share		
Weighted average shares of common stock outstanding-basic	86,996	86,084
Basic earnings per common share	$1.42	$0.41
Diluted earnings per share		
Weighted average shares of common stock outstanding-basic	86,996	86,084
Incremental shares [(1)]	351	771
Weighted average shares of common stock outstanding-diluted	87,347	86,855
Diluted earnings per common share [(2)]	$1.42	$0.40

(1) Incremental shares consist primarily of unvested stock awards and performance shares.
(2) There were no anti-dilutive shares excluded from the calculation of diluted earnings per share for the three months ended December 31, 2017 and 2016.

8. COMMON STOCK EQUITY

Changes in common stock equity during the three months ended December 31, 2017, were as follows:

(Thousands)	Number of Shares	Common Stock	Premium on Common Stock	Accumulated Other Comprehensive (Loss) Income	Treasury Stock And Other	Retained Earnings	Total
Balance at September 30, 2017	86,556	$222,258	$219,696	$ (3,256)	$(70,039)	$867,984	$1,236,643
Net income						123,699	123,699
Other comprehensive income				(5,204)			(5,204)
Common stock issued:							
Incentive plan	525	1,453	13,951				15,404
Dividend reinvestment plan [(1)]	90		245		3,554		3,799
Waiver discount	554	1,384	21,306				22,690
Cash dividend declared ($.2725 per share)						(23,831)	(23,831)
Treasury stock and other	(250)		(56)		(25,374)		(25,430)
Balance at December 31, 2017	87,475	$225,095	$255,142	$ (8,460)	$(91,859)	$967,852	$1,347,770

(1) Shares sold through the DRP are issued from treasury stock at average cost, which may differ from the actual market price paid.

NJR satisfies its external common equity requirements, if any, through issuances of its common stock, including the proceeds from stock issuances under its DRP. The DRP allows NJR, at its option, to use treasury shares or newly issued shares to raise capital. NJR raised $3.8 million and $4.6 million of equity through the DRP, by issuing approximately 90,000 and 139,000 shares of treasury stock, during the three months ended December 31, 2017 and 2016, respectively. During the three months ended December 31, 2017, NJR raised approximately $22.7 million of equity by issuing approximately 554,000 new shares through the waiver discount feature of the DRP. NJR issued no new shares during the three months ended December 31, 2016.

20

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Accumulated Other Comprehensive Income (Loss)

The following table presents the changes in the components of accumulated other comprehensive income (loss), net of related tax effects during the three months ended December 31, 2017 and 2016:

(Thousands)	Available for Sale Securities	Postemployment Benefit Obligation		Total
Balance at September 30, 2017	$11,044	$(14,300)		$(3,256)
Other comprehensive (loss) income, net of tax				
Other comprehensive (loss), before reclassifications, net of tax of $851, $0, $851	(2,290)	—		(2,290)
Amounts reclassified from accumulated other comprehensive (loss) income, net of tax of $2,178, $(136), $2,042	(3,154)	240	(1)	(2,914)
Net current-period other comprehensive (loss) income, net of tax of $3,029, $(136), $2,893	(5,444)	240		(5,204)
Balance at December 31, 2017	$5,600	$(14,060)		$(8,460)
Balance as of September 30, 2016	$4,198	$(19,353)		$(15,155)
Other comprehensive income (loss), net of tax				
Other comprehensive income, before reclassifications, net of tax of $(4,840), $0, $(4,840)	7,042	—		7,042
Amounts reclassified from accumulated other comprehensive (loss) income, net of tax of $1,054, $(217), $837	(1,527)	317	(1)	(1,210)
Net current-period other comprehensive income, net of tax of $(3,786), $(217), $(4,003)	5,515	317		5,832
Balance as of December 31, 2016	$9,713	$(19,036)		$(9,323)

(1) Included in the computation of net periodic pension cost, a component of operations and maintenance expense on the Unaudited Condensed Consolidated Statements of Operations.

9. DEBT

NJR and NJNG finance working capital requirements and capital expenditures through various short-term debt and long-term financing arrangements, including a commercial paper program, committed unsecured credit facilities and private placement debt shelf facilities.

Credit Facilities

A summary of NJR's credit facility and NJNG's commercial paper program and credit facility are as follows:

(Thousands)	December 31, 2017	September 30, 2017	Expiration Dates
NJR			
Bank revolving credit facilities [1]	$ 425,000	$ 425,000	September 2020
Notes outstanding at end of period	$ 327,200	$ 255,000	
Weighted average interest rate at end of period	2.26 %	2.14 %	

Amount available at end of period [2]	$ 86,834	$ 156,601	
Bank revolving credit facilities [1]	$ 75,000	$ —	April 2018
Amount available at end of period	$ 75,000	$ —	
NJNG			
Bank revolving credit facilities [1]	$ 250,000	$ 250,000	May 2019
Commercial paper outstanding at end of period	$ 46,000	$ 11,000	
Weighted average interest rate at end of period	1.33 %	1.13 %	
Amount available at end of period [3]	$ 203,269	$ 238,269	

(1) Committed credit facilities, which require commitment fees on the unused amounts.

(2) Letters of credit outstanding total $11 million and $13.4 million for December 31, 2017 and September 30, 2017, respectively, which reduces amount available by the same amount.

(3) Letters of credit outstanding total $731,000 for both December 31, 2017 and September 30, 2017, which reduces the amount available by the same amount.

21

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

On December 14, 2017, NJR entered into a four-month, $75 million revolving line of credit facility, which will expire on April 14, 2018. As of December 31, 2017, there were no borrowings against the facility. On January 19, 2018, NJR amended the agreement to increase the available amount to $100 million.

Amounts available under credit facilities are reduced by bank or commercial paper borrowings, as applicable, and any outstanding letters of credit. Neither NJNG nor the results of its operations are obligated or pledged to support the NJR credit or debt shelf facilities.

Long-term Debt

NJNG

NJNG received $7.8 million and $9.6 million in December 2017 and 2016, respectively, in connection with the sale-leaseback of its natural gas meters. NJNG records a capital lease obligation that is paid over the term of the lease and has the option to purchase the meters back at fair value upon expiration of the lease. NJNG exercised early purchase options with respect to meter leases by making final principal payments of $1.1 million and $1 million during the three months ended December 31, 2017 and 2016, respectively.

NJR

On January 26, 2018, NJR entered into a variable-for-fixed interest rate swap on NJR's existing $100 million variable rate term loan due August 16, 2019, which fixed the variable rate at 2.84 percent.

10. EMPLOYEE BENEFIT PLANS

Pension and Other Postemployment Benefit Plans

The components of the net periodic cost for pension benefits, including the Company's Pension Equalization Plan, and OPEB costs (principally health care and life insurance) for employees and covered dependents were as follows:

	Pension Three Months Ended December 31,		OPEB Three Months Ended December 31,	
(Thousands)	2017	2016	2017	2016
Service cost	$2,035	$2,087	$1,152	$1,095
Interest cost	2,623	2,443	1,591	1,386
Expected return on plan assets	(4,910)	(4,828)	(1,338)	(1,192)
Recognized actuarial loss	1,884	2,207	1,165	1,093
Prior service cost amortization	27	27	(91)	(91)
Net periodic benefit cost	$1,659	$1,936	$2,479	$2,291

The Company does not expect to be required to make additional contributions to fund the pension plans during fiscal 2018 or 2019 based on current actuarial assumptions; however, funding requirements are uncertain and can depend significantly on changes in actuarial assumptions, returns on plan assets and changes in the demographics of eligible

employees and covered dependents. In addition, as in the past, the Company may elect to make contributions in excess of the minimum required amount to the plans. There were no discretionary contributions made during the three months ended December 31, 2017.

11. INCOME TAXES

ASC Topic 740, Income Taxes requires the use of an estimated annual effective tax rate for purposes of determining the income tax provision during interim reporting periods. In calculating its estimated annual effective tax rate, NJR considers forecasted annual pre-tax income and estimated permanent book versus tax differences, as well as tax credits associated with solar and wind projects. For investment tax credits, the estimate is based on solar projects that are probable of being completed and placed in service during the current fiscal year based on the best information available at each reporting period. For production tax credits, the estimate is based on the forecast of electricity produced during the current fiscal year based on the best information available at each reporting period. Adjustments to the effective tax rate and management's estimates will occur as information and assumptions change.

22

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Changes in tax laws or tax rates are recognized in the financial reporting period that includes the enactment date, the date in which the act is signed into law.

NJR evaluates its tax positions to determine the appropriate accounting and recognition of potential future obligations associated with unrecognized tax benefits. During the three months ended December 31, 2017 and 2016, the Company determined there was no need to recognize any liabilities associated with uncertain tax positions.

The Tax Act

On December 22, 2017, the President signed into law the Tax Act. The law made several changes to the Internal Revenue Code of 1986, as amended, the most impactful to the Company of which was a reduction in the federal corporate income tax rate from 35 percent to 21 percent that became effective January 1, 2018. Since the Company's fiscal year end is September 30, it is required by the Internal Revenue Code to calculate a statutory rate based upon the federal tax rates in effect before and after the effective date of the change in the taxable year that includes the effective date. Accordingly, the Company will use a federal statutory tax rate of 24.5 percent during fiscal 2018 and will use the enacted rate of 21 percent beginning in fiscal 2019.

As a result of the changes associated with the Tax Act, the Company revalued its deferred tax assets and liabilities at the enactment date to reflect the rates that will be in effect when the deferred tax assets and liabilities are expected to be realized or settled. The decrease of the net deferred tax liability at NJNG of $228 million, which includes $164.3 million for the revaluation of its deferred income taxes and $63.7 million for the accounting of the income tax effects on the revaluation, was recorded as a noncurrent regulatory liability on the Unaudited Condensed Consolidated Balance Sheets since it will be refunded to NJNG's ratepayers. The decrease of the net deferred tax liability for the remaining entities resulted in an income tax benefit of $57.6 million that was recognized on the Unaudited Condensed Consolidated Statements of Operations for the three months ended December 31, 2017.

The adjustments to deferred income taxes are based on assumptions the Company made with respect to its book versus tax differences and the timing of when those differences will reverse, including estimations associated with depreciation and the settlement of derivative unrealized amounts, therefore the revaluation of net deferred tax liabilities is subject to change as information and assumptions are updated.

Effective Tax Rate

The forecasted effective tax rates were 13.9 percent and 8.7 percent, for the three months ended December 31, 2017 and 2016, respectively. The increased effective tax rate is due primarily to an increase in forecasted pre-tax income combined with a decrease in forecasted tax credits for the fiscal year ending September 30, 2018, compared with the prior fiscal year, which more than offset the lower statutory rate. Forecasted tax credits, net of deferred income taxes, were $21.9 million and $36.4 million for fiscal 2018 and 2017, respectively.

To the extent there are discrete tax items that are not included in the forecasted effective tax rate, the actual effective tax rate will differ from the estimated annual effective tax rate. The Company recognized $2.8 million and $1.2 million during the three months ended December 31, 2017 and 2016, respectively, in excess tax benefits associated with the vesting of share-based awards, as a component of income tax (benefit) provision in its Unaudited Condensed Consolidated Statements of Operations. In addition, as discussed further above, the Company recognized a tax benefit

of $57.6 million during the three months ended December 31, 2017. As a result of these discrete items, NJR’s actual effective tax rate was (68.2) percent and 5.5 percent as of December 31, 2017 and 2016, respectively.

Other Tax Items

As of December 31, 2017, the Company has federal and state income tax net operating losses of approximately $125.3 million and $526.4 million, respectively, which generally have a life of 20 years. The Company has recorded deferred federal and state tax assets of approximately $28.5 million and $27.7 million, respectively, on the Unaudited Condensed Consolidated Balance Sheets, reflecting the tax benefits associated with these net operating losses. As of September 30, 2017, the Company had federal and state income tax net operating losses of approximately $125.3 million and $471.7 million, respectively, and deferred federal and state tax assets of approximately $28.5 million and $23.6 million, respectively.

As of December 31, 2017 and September 30, 2017, the Company recorded a valuation allowance associated with state net operating loss carryforwards of $1.3 million and $1 million, respectively, related to Clean Energy Ventures in the state of Montana. There were no other valuation allowances needed for the Company as of December 31, 2017. In addition, as of December 31,

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

2017 and September 30, 2017, the Company had an ITC/PTC carryforward of approximately $122.9 million and $109.3 million, respectively, which each have a life of 20 years. The Company expects to utilize this entire carryforward, which would begin to expire in fiscal 2035.

In December 2015, the Consolidated Appropriations Act extended the 30 percent ITC for solar property that is under construction on or before December 31, 2019. The credit will decline to 26 percent for property under construction during 2020 and to 22 percent for property under construction during 2021. For any property that is under construction before 2022, but not placed in service before 2024, the ITC will be reduced to 10 percent. In addition, the PTC was extended for five years through December 31, 2019, with a gradual three year phase out for any project for which construction of the facility begins after December 31, 2016.

12. COMMITMENTS AND CONTINGENT LIABILITIES

Cash Commitments

NJNG has entered into long-term contracts, expiring at various dates through September 2024, for the supply, storage and transportation of natural gas. These contracts include fixed charges of approximately $75.9 million at current contract rates and volumes for the remainder of the fiscal year, which are recoverable through BGSS.

For the purpose of securing storage and pipeline capacity, Energy Services enters into storage and pipeline capacity contracts, which require the payment of certain demand charges by Energy Services to maintain the ability to access such natural gas storage or pipeline capacity, during a fixed time period, which generally ranges from one to 10 years. Demand charges are established by interstate storage and pipeline operators and are regulated by FERC. These demand charges represent commitments to pay storage providers or pipeline companies for the right to store and/or transport natural gas utilizing their respective assets.

Commitments as of December 31, 2017, for natural gas purchases and future demand fees for the next five fiscal year periods are as follows:

(Thousands)	2018	2019	2020	2021	2022	Thereafter
Energy Services:						
Natural gas purchases	$287,394	$117,129	$21,504	$11,443	$—	$—
Storage demand fees	24,479	22,933	13,573	9,263	6,055	3,523
Pipeline demand fees	59,067	50,562	39,292	23,348	19,087	18,977
Sub-total Energy Services	$370,940	$190,624	$74,369	$44,054	$25,142	$22,500
NJNG:						
Natural gas purchases	$39,542	$41,287	$40,046	$38,234	$38,794	$79,894
Storage demand fees	22,531	27,193	16,482	9,380	8,952	11,373
Pipeline demand fees	53,406	75,718	101,087	91,202	89,828	669,099
Sub-total NJNG	$115,479	$144,198	$157,615	$138,816	$137,574	$760,366
Total	$486,419	$334,822	$231,984	$182,870	$162,716	$782,866

Legal Proceedings

Manufactured Gas Plant Remediation

NJNG is responsible for the remedial cleanup of five MGP sites, dating back to gas operations in the late 1800s and early 1900s, which contain contaminated residues from former gas manufacturing operations. NJNG is currently involved in administrative proceedings with the NJDEP, and participating in various studies and investigations by outside consultants, to determine the nature and extent of any such contaminated residues and to develop appropriate programs of remedial action, where warranted, under Administrative Consent Orders or Memoranda of Agreement with the NJDEP.

NJNG recovers its remediation expenditures, including carrying costs, over rolling seven-year periods pursuant to a RAC approved by the BPU. NJNG currently recovers approximately $9.4 million annually through its SBC RAC. On November 17, 2017, NJNG filed its annual SBC application requesting a reduction in the RAC, which will decrease the annual recovery to $7 million, effective April 1, 2018. As of December 31, 2017, $31.2 million of previously incurred remediation costs, net of recoveries from customers and insurance proceeds, are included in regulatory assets on the Unaudited Condensed Consolidated Balance Sheets.

In December 2017, the NJDEP contacted NJNG regarding its association with a parcel of land, located within NJNG's territory, which may have been a MGP site for a period of time. NJNG is investigating to determine the nature and extent of its relationship to the parcel, its previous owner and the operations conducted on the site. NJNG will continue to gather information relevant to the site in question, to determine if additional inquiry and inspection is warranted and whether a potential obligation, if any, exists to undertake remedial action.

NJNG periodically, and at least annually, performs an environmental review of the MGP sites, including a review of potential liability for investigation and remedial action. NJNG estimated at the time of the most recent review that total future expenditures to remediate and monitor the five MGP sites for which it is responsible, including potential liabilities for Natural Resource Damages that might be brought by the NJDEP for alleged injury to groundwater or other natural resources concerning these sites, will range from approximately $117.6 million to $205.2 million. NJNG's estimate of these liabilities is based upon known facts, existing technology and enacted laws and regulations in place when the review was completed. Where it is probable that costs will be incurred, and the information is sufficient to establish a range of possible liability, NJNG accrues the most likely amount in the range. If no point within the range is more likely than the other, it is NJNG's policy to accrue the lower end of the range. Accordingly, NJNG recorded an MGP remediation liability and a corresponding regulatory asset on the Unaudited Condensed Consolidated Balance Sheets of $149 million as of September 30, 2017, based on the most likely amount at year end and $144 million as of December 31, 2017, which includes adjustments for actual expenditures during fiscal 2018. The actual costs to be incurred by NJNG are dependent upon several factors, including final determination of remedial action, changing technologies and governmental regulations, the ultimate ability of other responsible parties to pay and any insurance recoveries.

NJNG will continue to seek recovery of MGP-related costs through the RAC. If any future regulatory position indicates that the recovery of such costs is not probable, the related non-recoverable costs would be charged to earnings in the period of such determination.

General

The Company is involved, and from time to time in the future may be involved, in a number of pending and threatened judicial, regulatory and arbitration proceedings relating to matters that arise in the ordinary course of business. In view of the inherent difficulty of predicting the outcome of litigation matters, particularly when such matters are in their early stages or where the claimants seek indeterminate damages, the Company cannot state with confidence what the eventual outcome of the pending litigation will be, what the timing of the ultimate resolution of these matters will be, or what the eventual loss, fines or penalties related to each pending matter will be, if any. In accordance with applicable accounting guidance, NJR establishes reserves for litigation for those matters that present loss contingencies as to which it is both probable that a loss will be incurred and the amount of such loss can be reasonably estimated. Based upon currently available information, NJR believes that the results of litigation that is currently pending, taken together, will not have a materially adverse effect on the Company’s financial condition, results of operations or cash flows. The actual results of resolving the pending litigation matters may be substantially higher than the amounts reserved.

The foregoing statements about NJR’s litigation are based upon the Company’s judgments, assumptions and estimates and are necessarily subjective and uncertain. The Company has a number of threatened and pending litigation matters at various stages. Certain of the Company’s significant litigation is described below.

In February 2015, a natural gas fire and explosion occurred in Stafford Township, New Jersey as a result of a natural gas leak emanating from an underground pipe. There were no fatalities, although several employees of NJNG were injured and several homes were damaged. NJNG notified its insurance carrier and believes that any costs associated with the incident, including attorneys' fees, property damage and other losses, will be substantially covered by insurance. The Company believes the resolution of any potential claims associated with the incident will not have a material effect on its financial condition, results of operations or cash flows. As of December 31, 2017, NJNG estimates that liabilities associated with claims will range between $600,000 and $3.2 million and has accrued the lower end of the range, as we do not believe there is an amount within the range that is more probable than any other.

25

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

13. REPORTING SEGMENT AND OTHER OPERATIONS DATA

The Company organizes its businesses based on a combination of factors, including its products and its regulatory environment. As a result, the Company manages its businesses through the following reporting segments and other operations: the Natural Gas Distribution segment consists of regulated energy and off-system, capacity and storage management operations; the Clean Energy Ventures segment consists of capital investments in clean energy projects; the Energy Services segment consists of unregulated wholesale and retail energy operations; the Midstream segment consists of the Company's investments in natural gas transportation and storage facilities; the Home Services and Other operations consist of heating, cooling and water appliance sales, installations and services, other investments and general corporate activities.

Information related to the Company's various reporting segments and other operations is detailed below:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Operating revenues		
Natural Gas Distribution		
External customers	$209,787	$185,556
Clean Energy Ventures		
External customers	13,996	7,567
Energy Services		
External customers [(1)]	472,171	338,930
Intercompany	5,810	(1,749)
Subtotal	701,764	530,304
Home Services and Other		
External customers	9,351	8,975
Intercompany	606	1,031
Eliminations	(6,416)	718
Total	$705,305	$541,028
Depreciation and amortization		
Natural Gas Distribution	$12,783	$12,030
Clean Energy Ventures	8,935	7,041
Energy Services	14	16
Midstream	1	1
Subtotal	21,733	19,088
Home Services and Other	188	221
Eliminations	(67)	(49)
Total	$21,854	$19,260
Interest income [(2)]		
Natural Gas Distribution	$119	$75
Midstream	664	462
Subtotal	783	537
Home Services and Other	204	121
Eliminations	(931)	(583)

Total	$56	$75

(1) Includes sales to Canada, which accounted for .02 and 1.9 percent of total operating revenues during the three months ended December 31, 2017 and 2016, respectively.
(2) Included in other income, net on the Unaudited Condensed Consolidated Statements of Operations.

26

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

(Thousands)	Three Months Ended December 31, 2017	2016
Interest expense, net of capitalized interest		
Natural Gas Distribution	$6,536	$6,824
Clean Energy Ventures	4,208	3,324
Energy Services	1,257	571
Midstream	309	56
Subtotal	12,310	10,775
Home Services and Other	90	74
Eliminations	(495)	(234)
Total	$11,905	$10,615
Income tax provision (benefit)		
Natural Gas Distribution	$11,704	$14,887
Clean Energy Ventures	(73,988)	(11,887)
Energy Services	13,743	(3,176)
Midstream	(12,843)	1,649
Subtotal	(61,384)	1,473
Home Services and Other	11,698	(245)
Eliminations	(482)	790
Total	$(50,168)	$2,018
Equity in earnings of affiliates		
Midstream	$4,129	$3,331
Eliminations	(865)	(1,020)
Total	$3,264	$2,311
Net financial earnings		
Natural Gas Distribution	$34,109	$30,348
Clean Energy Ventures	71,250	2,842
Energy Services	20,274	3,487
Midstream	17,511	2,387
Subtotal	143,144	39,064
Home Services and Other	(7,716)	1,542
Eliminations	(95)	(223)
Total	$135,333	$40,383
Capital expenditures		
Natural Gas Distribution	$47,390	$38,855
Clean Energy Ventures	18,387	46,785
Subtotal	65,777	85,640
Home Services and Other	1,313	171
Total	$67,090	$85,811
Investments in equity investees		
Midstream	$7,202	$4,636
Total	$7,202	$4,636

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

The Chief Executive Officer, who uses NFE as a measure of profit or loss in measuring the results of the Company's segments and operations, is the chief operating decision maker of the Company. A reconciliation of consolidated NFE to consolidated net income is as follows:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Net financial earnings	$135,333	$40,383
Less:		
Unrealized loss on derivative instruments and related transactions	34,855	28,302
Tax effect	(8,059)	(9,757)
Effects of economic hedging related to natural gas inventory	(25,387)	(17,939)
Tax effect	8,244	6,204
Net income to NFE tax adjustment	1,981	(1,356)
Net income	$123,699	$34,929

The Company uses derivative instruments as economic hedges of purchases and sales of physical gas inventory. For GAAP purposes, these derivatives are recorded at fair value and related changes in fair value are included in reported earnings. Revenues and cost of gas related to physical gas flow is recognized when the gas is delivered to customers. Consequently, there is a mismatch in the timing of earnings recognition between the economic hedges and physical gas flows. Timing differences occur in two ways:

- unrealized gains and losses on derivatives are recognized in reported earnings in periods prior to physical gas inventory flows; and
- unrealized gains and losses of prior periods are reclassified as realized gains and losses when derivatives are settled in the same period as physical gas inventory movements occur.

NFE is a measure of the earnings based on eliminating these timing differences, to effectively match the earnings effects of the economic hedges with the physical sale of gas, SRECs and foreign currency contracts. Consequently, to reconcile between net income and NFE, current period unrealized gains and losses on the derivatives are excluded from NFE as a reconciling item. Additionally, realized derivative gains and losses are also included in current period net income. However, NFE includes only realized gains and losses related to natural gas sold out of inventory, effectively matching the full earnings effects of the derivatives with realized margins on physical gas flows. Included in the tax effects are current and deferred income tax expense corresponding with the non-GAAP measure. Also included in the tax effects during the three month ended December 31, 2017, are the impacts of the Tax Act and resulting revaluation of the deferred income taxes that arose from derivative and hedging activity as measured under NFE. The revaluation caused the effective tax rate on reconciling items to differ from the statutory rate in effect for the quarter. NJR also calculates a quarterly tax adjustment based on an estimated annual effective tax rate for NFE purposes.

The Company's assets for the various business segments and business operations are detailed below:

(Thousands)	December 31, 2017	September 30, 2017

Assets at end of period:		
Natural Gas Distribution	$ 2,590,623	$ 2,519,578
Clean Energy Ventures	797,951	771,340
Energy Services	547,388	398,277
Midstream	248,498	232,806
Subtotal	4,184,460	3,922,001
Home Services and Other	125,149	114,801
Intercompany assets [1]	(122,681)	(108,295)
Total	$ 4,186,928	$ 3,928,507

(1) Consists of transactions between subsidiaries that are eliminated and reclassified in consolidation.

14. RELATED PARTY TRANSACTIONS

Effective April 1, 2010, NJNG entered into a 10-year agreement for 3 Bcf of firm storage capacity with Steckman Ridge. Under the terms of the agreement, NJNG incurs demand fees at market rates of approximately $9.3 million annually, a portion of which is eliminated in consolidation. These fees are recoverable through NJNG's BGSS mechanism and are included as a component of regulatory assets.

New Jersey Resources Corporation
Part I

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Energy Services may periodically enter into storage or park and loan agreements with its affiliated FERC-jurisdictional natural gas storage facility, Steckman Ridge. As of December 31, 2017, Energy Services has entered into transactions with Steckman Ridge for varying terms, all of which expire by October 31, 2020.

Demand fees, net of eliminations, associated with Steckman Ridge were as follows:

(Thousands)	Three Months Ended December 31, 2017	2016
Natural Gas Distribution	$1,448	$1,410
Energy Services	701	701
Total	$2,149	$2,111

The following table summarizes demand fees payable to Steckman Ridge as of:

(Thousands)	December 31, 2017	September 30, 2017
Natural Gas Distribution	$ 775	$ 775
Energy Services	375	377
Total	$ 1,150	$ 1,152

NJNG and Energy Services have entered into various asset management agreements, the effects of which are eliminated in consolidation. Under the terms of these agreements, NJNG releases certain transportation and storage contracts to Energy Services. As of December 31, 2017, NJNG and Energy Services had four asset management agreements with expiration dates ranging from February 28, 2018 through October 31, 2020.

NJNG has entered into a 15-year transportation precedent agreement for committed capacity of 180,000 Dths per day with PennEast, to commence when PennEast is in service.

15. ACQUISITION

On October 27, 2017, Adelphia, an indirect wholly owned subsidiary of NJR, entered into a Purchase and Sale Agreement with Talen pursuant to which Adelphia will acquire all of Talen's membership interests in IEC for a base purchase price of $166 million. As additional consideration, Adelphia will pay Talen specified amounts of up to $23 million contingent upon the achievement of certain regulatory approvals and binding natural gas capacity commitments. On November 7, 2017, the Company made an initial payment of $10 million towards the base purchase price, which is included in other noncurrent assets on the Unaudited Condensed Consolidated Balance Sheets.

IEC owns an existing 84-mile pipeline in southeastern Pennsylvania. The transaction is expected to close following receipt of necessary permits and regulatory actions including those from the FERC and the Pennsylvania Public Utility Commission. Upon the closing, Adelphia will acquire IEC and, with it, IEC's existing pipeline, related assets and rights of way. Adelphia has also agreed to provide firm natural gas transportation service for ten years following the closing to two power generators owned by affiliates of Talen that are currently served by IEC.
1
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF

OPERATIONS

Critical Accounting Policies

A summary of our critical accounting policies is included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the period ended September 30, 2017. Our critical accounting policies have not changed from those reported in the 2017 Annual Report on Form 10-K.

Recently Issued Accounting Standards

Refer to Note 2. Summary of Significant Accounting Policies for discussion of recently issued accounting standards.

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Management's Overview

Consolidated

NJR is an energy services holding company providing retail natural gas service in New Jersey and wholesale and retail natural gas and related energy services to customers in the United States and Canada. In addition, we invest in clean energy projects, midstream assets and provide various repair, sales and installations services. A more detailed description of our organizational structure can be found in Item 1. Business of our 2017 Annual Report on Form 10-K.

Reporting Segments

We have four primary reporting segments as presented in the chart below:

In addition to our four reporting segments, we have non-utility operations that either provide corporate support services or do not meet the criteria to be treated as a separate reporting segment. These operations, which comprise Home Services and Other, include: appliance repair services, sales and installations at NJRHS; and commercial real estate holdings at CR&R.

The Tax Act

On December 22, 2017, the President signed into law the Tax Act. The newly enacted legislation became effective January 1, 2018, and includes a broad range of tax reform initiatives, including a reduction to the federal statutory corporate tax rate from 35 percent to 21 percent, modification of bonus depreciation and changes to the deductibility of certain business related expenses. ASC Topic 740, Income Taxes, requires the impact of changes in tax laws or tax rates to be recognized in the financial reporting period that includes that enactment date, which is the date the act is signed into law.

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

As a result of the change to the federal statutory corporate tax rate, we revalued our deferred tax assets and liabilities at the enactment date to reflect the rates expected to be in effect when the deferred tax assets and liabilities are realized or settled. The decrease of the net deferred tax liability at NJNG of $228 million, which includes $164.3 million for the revaluation of its deferred income taxes and $63.7 million for the accounting of the income tax effects on the revaluation, was recorded as a noncurrent regulatory liability on the Unaudited Condensed Consolidated Balance Sheets and will be refunded to ratepayers. The decrease of our net deferred tax liability, that was recognized on the Unaudited Condensed Consolidated Statements of Operations, for the remaining entities was as follows:

(Thousands)	Three Months Ended December 31, 2017
Income tax (benefit) provision	
Clean Energy Ventures	$(62,657)
Energy Services	9,107
Midstream	(13,989)
Home Services and Other	9,974
Total	$(57,565)

Since these adjustments are based on assumptions the Company made with respect to its book versus tax differences and the timing of when those differences will reverse, including estimations associated with depreciation and the settlement of derivative unrealized amounts, therefore the revaluation of our net deferred tax liabilities is subject to change as information and assumptions are updated.

On January 31, 2018, the BPU issued an Order directing the New Jersey utilities to submit filings by March 2, 2018, proposing the prospective change in rates as a result of the Tax Act, the method to return to customers the rate difference from January 1, 2018 through the effective date of the rate change, and the method by which the excess deferred taxes will be returned to customers. The excess deferred taxes are primarily related to timing differences associated with utility plant depreciation and are subject to IRS normalization rules, which require amortization over the remaining life of the utility plant. The return to customers of the plant-related excess deferred taxes, as well as any non-plant related excess deferred taxes will be addressed in NJNG’s filing to the BPU. See Note 3. Regulation for a more detailed discussion on the BPU order.

Since the Company's fiscal year end is September 30, it is required by the Internal Revenue Code to calculate a statutory rate based upon the federal tax rates in effect before and after the effective date of the change in the taxable year that includes the effective date. Accordingly, the Company will use a federal statutory tax rate of 24.5 percent during fiscal 2018 and will use the enacted rate of 21 percent beginning in fiscal 2019. See Note 11. Income Taxes for a more detailed discussion on the Tax Act.

Operating Results

Net income (loss) by reporting segment and operations are as follows:

Three Months Ended

	December 31,			
(Thousands)	2017		2016	
Net income (loss)				
Natural Gas Distribution	$34,109	28 %	$30,348	87 %
Clean Energy Ventures	69,269	56	4,198	12
Energy Services	11,120	9	(4,790)	(14)
Midstream	17,511	13	2,387	7
Home Services and Other	(7,716)	(6)	1,542	4
Eliminations [1]	(594)	—	1,244	4
Total	$123,699	100 %	$34,929	100 %

(1) Consists of transactions between subsidiaries that are eliminated in consolidation.

The increase of $88.8 million in net income was driven primarily by an income tax benefit of $57.6 million associated with the Tax Act and increased operating income at Energy Services due primarily to increases in the average price of natural gas and volumes related to the weather in December 2017 being 14.4 percent colder than normal. The primary drivers of the changes noted above are described in more detail in the individual segment discussions.

31

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Assets by reporting segment and operations are as follows:

(Thousands)	December 31, 2017		September 30, 2017	
Assets				
Natural Gas Distribution	$2,590,623	62 %	$2,519,578	64 %
Clean Energy Ventures	797,951	19	771,340	20
Energy Services	547,388	13	398,277	10
Midstream	248,498	6	232,806	6
Home Services and Other	125,149	3	114,801	3
Intercompany assets [1]	(122,681)	(3)	(108,295)	(3)
Total	$4,186,928	100 %	$3,928,507	100 %

(1) Consists of transactions between subsidiaries that are eliminated in consolidation.

The increase in assets was due primarily to increased accounts receivable at Energy Services and our Natural Gas Distribution segment, as well as additional utility plant.

Non-GAAP Financial Measures

Our management uses NFE, a non-GAAP financial measure, when evaluating our operating results. Energy Services economically hedges its natural gas inventory with financial derivative instruments. NFE is a measure of the earnings based on eliminating timing differences surrounding the recognition of certain gains or losses, to effectively match the earnings effects of the economic hedges with the physical sale of gas and, therefore, eliminates the impact of volatility to GAAP earnings associated with the derivative instruments. There is a related tax effect on current and deferred income tax expense corresponding with this non-GAAP measure. Also included in the tax effect during the three month ended December 31, 2017, are the impacts of the Tax Act and resulting revaluation of the deferred income taxes that arose from derivative and hedging activity as measured under NFE. The revaluation caused the effective tax rate on reconciling items to differ from the statutory rate in effect for the quarter. To the extent we utilize forwards, futures, or other derivatives to hedge forecasted SREC production, unrealized gains and losses are also eliminated for NFE purposes.

GAAP requires us, during the interim periods, to estimate our annual effective tax rate and use this rate to calculate the year-to-date tax provision. We also determine an annual estimated effective tax rate for NFE purposes and calculate a quarterly tax adjustment based on the differences between our forecasted net income and our forecasted NFE for the fiscal year. Since the annual estimated effective tax rate is based on certain forecasted assumptions, including estimates surrounding completion of Clean Energy Ventures projects, the rate and resulting NFE are subject to change. Since this adjustment is made to reflect the forecasted tax rate, no adjustment is needed at year end.

Non-GAAP financial measures are not in accordance with, or an alternative to, GAAP and should be considered in addition to, and not as a substitute for or a replacement of, the comparable GAAP measure and should be read in conjunction with those GAAP results. Below is a reconciliation of consolidated net income, the most directly comparable GAAP measure, to NFE:

Three Months Ended December 31,

(Thousands, except per share data)	2017	2016
Net income	$123,699	$34,929
Add:		
Unrealized loss on derivative instruments and related transactions	34,855	28,302
Tax effect	(8,059)	(9,757)
Effects of economic hedging related to natural gas inventory [1]	(25,387)	(17,939)
Tax effect	8,244	6,204
NFE tax adjustment	1,981	(1,356)
Net financial earnings	$135,333	$40,383
Basic earnings per share	$1.42	$0.41
Add:		
Unrealized loss on derivative instruments and related transactions	0.40	0.33
Tax effect	(0.09)	(0.11)
Effects of economic hedging related to natural gas inventory [1]	(0.29)	(0.21)
Tax effect	0.10	0.07
NFE tax adjustment	0.02	(0.02)
Basic NFE per share	$1.56	$0.47

(1) Effects of hedging natural gas inventory transactions where the economic impact is realized in a future period.

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

NFE by reporting segment and other operations, discussed in more detail within the operating results sections of each segment, is summarized as follows:

	Three Months Ended December 31,			
($ in Thousands)	2017		2016	
Net financial earnings (loss)				
Natural Gas Distribution	$34,109	25 %	$30,348	75 %
Clean Energy Ventures	71,250	53	2,842	7
Energy Services	20,274	15	3,487	9
Midstream	17,511	13	2,387	6
Home Services and Other	(7,716)	(6)	1,542	4
Eliminations [1]	(95)	—	(223)	(1)
Total	$135,333	100 %	$40,383	100 %

(1) Consists of transactions between subsidiaries that are eliminated in consolidation.

The increase of $95 million in NFE during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, was due primarily to the income tax benefit of $57.6 million associated with the Tax Act, as previously discussed, and higher financial margin generated at Energy Services due primarily to colder weather in December 2017, resulting in increased storage withdrawals due to higher demand coupled with higher volatility allowing Energy Services to capture additional margin from natural gas price spreads.

Natural Gas Distribution Segment

Overview

Our Natural Gas Distribution segment is comprised of NJNG, a natural gas utility that provides regulated retail natural gas service in central and northern New Jersey to approximately 534,400 residential and commercial customers in its service territory and also participates in the off-system sales and capacity release markets. The business is subject to various risks, which can negatively impact customer growth, operating and financing costs, fluctuations in commodity prices and customer conservation efforts. These risks include, but are not limited to, adverse economic conditions, customer usage, certain regulatory actions, environmental remediation and severe weather conditions. It is often difficult to predict the impact of events or trends associated with these risks.

In addition, NJNG's business is seasonal by nature, as weather conditions directly influence the volume of natural gas delivered to customers on an annual basis. Specifically, customer demand substantially increases during the winter months when natural gas is used for heating purposes. As a result, NJNG receives most of its natural gas distribution revenues during the first and second fiscal quarters and is subject to variations in earnings and working capital during the year.

As a regulated company, NJNG is required to recognize the impact of regulatory decisions on its financial statements. See Note 3. Regulation in the accompanying Unaudited Condensed Consolidated Financial Statements for a more detailed discussion on regulatory actions, including filings related to programs and associated expenditures, as well as rate requests related to recovery of capital investments and operating costs.

NJNG's operations are managed with the goal of providing safe and reliable service, growing its customer base, diversifying its gross margin, promoting clean energy programs and mitigating the risks discussed above through several key initiatives, including:

- earning a reasonable rate of return on the investments in its natural gas distribution and transmission businesses, as well as timely recovery of all prudently incurred costs to provide safe and reliable service throughout NJNG's territory;
- continuing to invest in the safety and integrity of its infrastructure;
- managing its customer growth rate, which NJNG expects will be approximately 1.7 percent annually through fiscal 2020;
- maintaining a collaborative relationship with the BPU on regulatory initiatives, including:
  - planning and authorization of infrastructure investments;
  - utilizing BGSS incentive programs through BPU-approved mechanisms to reduce gas costs and generate margin;
  - pursuing rate and regulatory strategies to stabilize and decouple margin, including CIP; and
  - administering and promoting NJNG's BPU-approved SAVEGREEN Project;

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

- managing the volatility of wholesale natural gas prices through a hedging program designed to keep customers' BGSS rates as stable as possible; and

- working with the NJDEP and BPU to manage its financial obligations related to remediation activities associated with its former MGP sites.

Infrastructure projects

NJNG has significant annual capital expenditures associated with the management of its natural gas distribution and transmission system, including new utility plant associated with customer growth and its associated pipeline integrity management and infrastructure programs. Below is a summary of NJNG's capital expenditures, including accruals, for the three months ended December 31, 2017, and estimates of expected investments for fiscal 2018 and 2019:

Estimated capital expenditures are reviewed on a regular basis and may vary based on the ongoing effects of regulatory oversight, environmental regulations, unforeseen events and the ability to access capital.

SAFE and NJ RISE

NJNG continues to implement BPU-approved infrastructure projects that are designed to enhance the reliability and integrity of NJNG's gas distribution system.

The BPU approved recovery of SAFE I capital investments through September 30, 2016, and approved the rate mechanism and extension of SAFE II for an additional five years to replace the remaining unprotected steel mains and services from its natural gas distribution system at an estimated cost of approximately $200 million, excluding AFUDC. The accelerated cost recovery methodology for the $157.5 million associated with the extension of SAFE II was approved in NJNG's new base rates. The remaining $42.5 million in capital expenditures will be requested for recovery in a future base rate case.

The BPU approved the recovery of NJNG's NJ RISE capital infrastructure program, which consists of six capital investment projects estimated to cost $102.5 million, excluding AFUDC, for gas distribution storm hardening and mitigation projects, along with associated depreciation expense. These system enhancements are intended to minimize service impacts during extreme weather events to customers that live in the most storm prone areas of NJNG's service territory.

In March 2017, NJNG filed its annual petition with the BPU requesting a base rate increase for the recovery of NJ RISE and SAFE II capital investment costs, with a weighted cost of capital of 6.9 percent including a return on equity of 9.75 percent, related to the period ending June 30, 2017, based on estimates, pursuant to the September 2016 base rate case. In July 2017, NJNG filed an update to this petition with actual costs, requesting a $4.1 million annual increase in recoveries, which was approved by the BPU, effective October 1, 2017.

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Southern Reliability Link

The SRL is an approximate 30-mile, 30-inch transmission main designed to support improved system reliability and integrity in the southern portion of NJNG's service territory, estimated to cost between $180 million and $200 million. In January 2016, the BPU issued an order approving NJNG's modified, proposed SRL pipeline installation, operation and route selection. In March 2016, the BPU issued an order designating the SRL route and exempting the SRL from municipal land use ordinances, regulations, permits and license requirements. In February 2017, the NJDEP issued a permit authorizing construction of the SRL within the jurisdiction of the Coastal Area Facility Review Act, as well as a Freshwater Wetlands permit.

In September 2017, the NJ Pinelands Commission approved construction of the SRL as being compliant with the Commission's Comprehensive Management Plan. All approvals and permits have been appealed by third parties. Once the final road opening permits and easements are secured, construction is expected to begin, with an estimated in-service date during the first quarter of fiscal 2019.

Customer growth

In conducting NJNG's business, management focuses on factors it believes may have significant influence on its future financial results. NJNG's policy is to work with all stakeholders, including customers, regulators and policymakers, to achieve favorable results. These factors include the rate of NJNG's customer growth in its service territory, which can be influenced by political and regulatory policies, the delivered cost of natural gas compared with competing fuels, interest rates and general economic and business conditions. NJNG's total customers include the following:

	December 31, 2017	December 31, 2016
Firm customers		
Residential	463,679	451,587
Commercial, industrial & other	28,656	27,995
Residential transport	31,969	35,698
Commercial transport	10,089	10,149
Total firm customers	534,393	525,429
Other	49	64
Total customers	534,442	525,493

During the three months ended December 31, 2017 and 2016, respectively, NJNG added 2,637 and 1,866 new customers and converted 113 and 196 existing customers to natural gas heat and other services. This customer growth, as well as commercial customers who switched from interruptible to firm natural gas service, will contribute approximately $1.5 million, on an annualized basis, to utility gross margin.

In addition, NJNG currently expects to add approximately 26,000 to 28,000 new customers during the three-year period of fiscal 2018 to 2020. Based on information from municipalities and developers, as well as external industry analysts and management's experience, NJNG estimates that approximately 60 percent of the growth will come from new construction markets and 40 percent from customer conversions to natural gas from other fuel sources. This new customer and conversion growth would increase utility gross margin under NJNG's base rates by approximately $5.3

million annually, as calculated under NJNG's CIP tariff. See the Natural Gas Distribution Segment Operating Results section of Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations that follows for a definition and further discussion of utility gross margin.

SAVEGREEN

SAVEGREEN conducts home energy audits and provides various grants, incentives and financing alternatives, which are designed to encourage the installation of high-efficiency heating and cooling equipment and other energy-efficiency upgrades. Depending on the specific incentive or approval, NJNG recovers costs associated with the programs over a two to 10-year period through a tariff rider mechanism.

Since inception, $153.1 million in grants, rebates and loans has been provided to customers, with a total annual recovery of approximately $20 million. In June 2016, the BPU approved NJNG's extension of SAVEGREEN through December 31, 2018. In October 2016, the BPU approved NJNG’s filing to maintain the existing SAVEGREEN recovery rate. On October 20, 2017, the BPU approved NJNG's filing to decrease its EE recovery rate, which would result in an annual decrease of $3.9 million, effective November 1, 2017. The recovery includes a weighted average cost of capital that ranges from 6.69 percent to 7.76 percent, with a return on equity of 9.75 percent to 10.3 percent.

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Conservation Incentive Program

The CIP facilitates normalizing NJNG's utility gross margin for variances not only due to weather but also for other factors affecting customer usage, such as conservation and energy efficiency. Recovery of utility gross margin for the non-weather variance through the CIP is limited to the amount of certain gas supply cost savings achieved and is subject to a variable margin revenue test. Additionally, recovery of the CIP utility gross margin is subject to an annual earnings test. An annual review of the CIP must be filed by June 1, coincident with NJNG's annual BGSS filing, during which NJNG can request rate changes to the CIP. In May 2014, the BPU approved the continuation of the CIP program with no expiration date. In September 2016, the BPU approved NJNG's filing to increase its CIP rates resulting in a $43.9 million annual recovery increase, effective October 2016. In September 2017, the BPU provisionally approved NJNG's petition to decrease its CIP rates, which will result in a $16.2 million annual recovery decrease, effective October 1, 2017.

NJNG's total utility firm gross margin includes the following adjustments related to the CIP mechanism:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Weather [1]	$(1,368)	$2,985
Usage	642	(125)
Total	$(726)	$2,860

(1) Compared with the CIP 20-year average, weather was 0.1 percent colder-than-normal and 6 percent warmer-than-normal during the three months ended December 31, 2017 and 2016, respectively.

As of December 31, 2017 and September 30, 2017, NJNG had $10 million and $17.7 million, respectively, in regulatory assets related to CIP to be collected from customers in future periods on the Unaudited Condensed Consolidated Balance Sheets.

Commodity prices

Our Natural Gas Distribution segment is affected by the price of natural gas, which can have a significant impact on our cash flows, short-term financing costs, the price of natural gas charged to our customers through the BGSS clause, our ability to collect accounts receivable, which impacts our bad debt expense, and our ability to maintain a competitive advantage over other fuel sources. Natural gas commodity prices may experience high volatility as shown in the graph below, which illustrates the daily natural gas prices[1] in the Northeast market region, also known as Tetco M-3.

(1) Data source from Platts, a division of McGraw Hill Financial.

The maximum daily price was $17.26 and $8.71 and the minimum daily price was $0.53 and $0.36 for the three months ended December 31, 2017 and 2016, respectively. A more detailed discussion of the impacts of the price of natural gas on operating revenues, gas purchases and cash flows can be found in the Results of Operations and Cash Flow sections of Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

BGSS

Recovery of natural gas costs

NJNG's cost of natural gas is passed through to our customers, without markup, by applying NJNG's authorized BGSS rate to actual therms delivered. There is no utility gross margin associated with BGSS costs; therefore, changes in such costs do not impact NJNG's earnings. NJNG monitors its actual gas costs in comparison to its BGSS rates to manage its cash flows associated with its allowed recovery of natural gas costs, which is facilitated through BPU-approved deferred accounting and the BGSS pricing mechanism. Accordingly, NJNG occasionally adjusts its periodic BGSS rates or can issue credits or refunds, as appropriate, for its residential and small commercial customers when the commodity cost varies from the existing BGSS rate. BGSS rates for its large commercial customers are adjusted monthly based on NYMEX prices.

In September 2017, the BPU provisionally approved maintaining NJNG's BGSS rate for residential and small commercial customers and an increase to its balancing charge rate, which will result in a $3.7 million increase to the annual revenues credited to BGSS, effective October 1, 2017. The balancing charge rate includes the cost of balancing natural gas deliveries with customer usage for sales and transportation customers and balancing charge revenues are credited to BGSS. During the three months ended December 31, 2016, NJNG issued bill credits of $19.3 million as a result of a decline in the wholesale price of natural gas. There were no bill credits issued during the three months ended December 31, 2017.

BGSS Incentive Programs

NJNG is eligible to receive financial incentives for reducing BGSS costs through a series of utility gross margin-sharing programs that include off-system sales, capacity release and storage incentive programs. These programs are designed to encourage better utilization and hedging of its natural gas supply, transportation and storage assets. Depending on the program, NJNG shares 80 or 85 percent of utility gross margin generated by these programs with firm customers. Should performance of the existing incentives or market conditions warrant, NJNG is permitted to propose a process to re-evaluate and discuss alternative incentive programs annually. Utility gross margin from incentive programs was $4.4 million and $3.8 million during the three months ended December 31, 2017 and 2016, respectively. A more detailed discussion of the impacts to utility gross margin can be found in the Natural Gas Distribution Operating Results section of Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Hedging

In order to provide relative price stability to its natural gas supply portfolio, NJNG employs a hedging strategy with the goal of having at least 75 percent of the Company's projected winter periodic BGSS gas sales volumes hedged by each November 1 and at least 25 percent of the projected BGSS gas sales hedged for the following April through March period. This is accomplished with the use of various financial instruments including futures, swaps and options used in conjunction with commodity and/or weather-related hedging activity.

Due to the capital-intensive nature of NJNG's operations, significant changes in interest rates can impact NJNG's results. NJNG entered into a treasury lock transaction to fix a benchmark treasury rate associated with debt issuance

expected in May 2018. The fair value of NJNG's treasury lock agreement is recorded as a component of regulatory assets or liabilities on the Unaudited Condensed Consolidated Balance Sheets since the Company believes that the market value upon settlement will be reflected in future rates. Upon settlement, any gain or loss will be amortized in earnings over the life of the future debt issuance.

A more detailed discussion of NJNG's debt can be found in the Liquidity and Capital Resources and Cash Flow sections of Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Societal Benefits Charge

USF

NJNG's qualifying customers are eligible for the USF program, which is administered by the New Jersey Department of Community Affairs, to help make energy bills more affordable. In September 2017, the BPU approved NJNG's annual USF compliance filing to decrease the statewide USF rate, which will result in a $2.6 million annual decrease, effective October 1, 2017.

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Environmental Remediation

NJNG is responsible for the environmental remediation of five MGP sites, which contain contaminated residues from former gas manufacturing operations that ceased operating at these sites by the mid-1950s and, in some cases, had been discontinued many years earlier. Actual MGP remediation costs may vary from management's estimates due to the developing nature of remediation requirements, regulatory decisions by the NJDEP and related litigation. NJNG reviews these costs at the end of each fiscal year and adjusts its liability and corresponding regulatory asset as necessary to reflect its expected future remediation obligation. Accordingly, NJNG recognized a regulatory asset and an obligation of $144 million as of December 31, 2017, a decrease of $5 million, compared with September 30, 2017.

Other regulatory filings and a more detailed discussion of the filings in this section can be found in Note 3. Regulation in the accompanying Unaudited Condensed Consolidated Financial Statements.

Operating Results

NJNG's operating results are as follows:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Operating revenues	$209,787	$185,556
Operating expenses		
Gas purchases [(1)]	84,755	64,186
Operation and maintenance	35,391	33,218
Regulatory rider expense	11,769	12,601
Depreciation and amortization	12,783	12,030
Energy and other taxes	13,750	12,149
Total operating expenses	158,448	134,184
Operating income	51,339	51,372
Other income, net	1,010	687
Interest expense, net of capitalized interest	6,536	6,824
Income tax provision	11,704	14,887
Net income	$34,109	$30,348

(1) Includes related party transactions of approximately $7.2 million and $2.9 million for the three months ended December 31, 2017 and 2016, respectively, a portion of which is eliminated in consolidation.

Operating Revenues and Gas Purchases

During the three months ended December 31, 2017, compared with the three months ended December 31, 2016, operating revenues and gas purchases increased by 13.1 percent and 32 percent, respectively. The factors contributing to the increases (decreases) in operating revenues and gas purchases are as follows:

Three Months
Ended
December 31,

(Thousands)	2017 v. 2016 Operating revenues	Gas purchases
Bill credits [1]	$19,260	$18,000
Firm sales	11,093	4,806
NJ RISE/SAFE II	1,448	—
Average BGSS rates [2]	1,156	1,070
CIP adjustments	(3,586)	—
Off-system sales	(2,700)	(3,054)
Other [3]	(2,440)	(253)
Total increase	$24,231	$20,569

(1) Operating revenues includes changes in sales tax of $1.3 million.
(2) Operating revenues includes changes in sales tax of $86,000.
(3) Other includes changes in rider rates, including those related to NJCEP and other programs.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

The increases in operating revenues and gas purchases during the three months ended December 31, 2017, compared with the three months ended December 31, 2016 were due primarily to:

- bill credits issued to residential and small commercial customers during fiscal 2017 that did not occur in fiscal 2018;
- increased firm sales due primarily to customer growth and higher usage related to weather being 5.6 percent colder; partially offset by
- a decrease in CIP due primarily to weather being colder during December 2017; and
- lower off-system sales due primarily to reduction in volumes of 24.9 percent, partially offset by an increase of 18.5 percent in the average price of gas sold.

Non-GAAP Financial Measures

Management uses utility gross margin, a non-GAAP financial measure, when evaluating the operating results of NJNG. NJNG's utility gross margin is defined as natural gas revenues less natural gas purchases, sales tax, and regulatory rider expenses, and may not be comparable to the definition of gross margin used by others in the natural gas distribution business and other industries. Management believes that utility gross margin provides a meaningful basis for evaluating utility operations since natural gas costs, sales tax and regulatory rider expenses are included in operating revenue and passed through to customers and, therefore, have no effect on utility gross margin. Non-GAAP financial measures are not in accordance with, or an alternative to, GAAP and should be considered in addition to, and not as a substitute for, the comparable GAAP measure.

Utility Gross Margin

A reconciliation of operating revenues, the closest GAAP financial measure, to NJNG's utility gross margin is as follows:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Operating revenues	$209,787	$185,556
Less:		
Gas purchases	84,755	64,186
Energy taxes [(1)]	12,404	10,882
Regulatory rider expense	11,769	12,601
Utility gross margin	$100,859	$97,887

(1) Energy taxes includes only sales tax on operating revenues, excluding tax-exempt sales.

Utility gross margin consists of three components:

- utility firm gross margin generated from only the delivery component of either a sales tariff or a transportation tariff from residential and commercial customers who receive natural gas service from NJNG;

- BGSS incentive programs, where revenues generated or savings achieved from BPU-approved off-system sales, capacity release or storage incentive programs are shared between customers and NJNG; and

- utility gross margin generated from off-tariff customers, as well as interruptible customers.

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

The following provides more information on the components of utility gross margin and associated throughput (Bcf) of natural gas delivered to customers:

	Three Months Ended December 31,			
	2017		2016	
($ in thousands)	Margin	Bcf	Margin	Bcf
Utility gross margin/throughput				
Residential	$64,735	13.6	$62,498	12.6
Commercial, industrial and other	13,918	2.6	13,696	2.4
Firm transportation	16,260	4.6	16,285	4.5
Total utility firm gross margin/throughput	94,913	20.8	92,479	19.5
BGSS incentive programs	4,435	38.7	3,784	43.6
Interruptible/off-tariff agreements	1,511	9.9	1,624	13.3
Total utility gross margin/throughput	$100,859	69.4	$97,887	76.4

Utility Firm Gross Margin

Utility firm gross margin increased $2.4 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to customer growth of $1.2 million and NJ RISE/SAFE II rate impact of $1.4 million.

BGSS Incentive Programs

The factors contributing to the increases (decreases) in utility gross margin generated by BGSS incentive programs are as follows:

(Thousands)	Three Months Ended December 31, 2017 v. 2016
Off-system sales	$ 354
Storage	301
Capacity release	(3)
Total increase	$ 652

The increase during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, was due primarily to an increase in capacity values contributing to increased margins in off-system sales and timing differences on injection activity in the storage incentive program.

Operation and Maintenance Expense

The factors contributing to the increases (decreases) in O&M expense is as follows:

(Thousands)	Three Months Ended December 31, 2017 v. 2016
Compensation and benefits	$ 622
Donations	725
Consulting	532
Other	294
Total increase	$ 2,173

The increase in O&M expense during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, was due primarily to higher compensation costs due primarily to increases in headcount and healthcare premiums, charitable contributions and consulting costs due primarily to an increase in software consulting costs and audit expenses.

Depreciation Expense

Depreciation expense increased $753,000 during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, as a result of additional utility plant being placed into service.

40

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Income Tax Provision

Income tax provision decreased $3.2 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to the decrease in the effective tax rate as a result of the new tax legislation.

Net Income

Net income increased $3.8 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to the decrease in the income tax provision, as discussed above, increased other income related to AFUDC interest earned on infrastructure projects and lower interest expense due to the purchase in lieu of redemption of the three FMBs that occurred during the second quarter of fiscal 2017.

Clean Energy Ventures Segment

Overview

Our Clean Energy Ventures segment actively pursues opportunities in the clean energy markets. Clean Energy Ventures has entered into various agreements to install solar net-metered systems for residential and commercial customers, as well as large commercial grid-connected projects. In addition, Clean Energy Ventures has entered into various long-term agreements, including PPAs, to supply energy from wind and solar projects.

The primary contributors toward the value of qualifying clean energy projects are tax incentives and SRECs. Changes in the federal statutes related to the ITC or PTC or in the marketplace and/or relevant legislation surrounding renewable clean energy credits, could significantly affect future results.

Solar

Since inception, Clean Energy Ventures has constructed a total of 190.9 MW of solar capacity and has an additional 21.4 MW under construction. Projects that are placed in service through December 31, 2019, qualify for a 30-percent federal ITC. The credit will decline to 26 percent for property under construction during 2020 and to 22 percent for property under construction during 2021. The ITC will be reduced to 10 percent for any property that is under construction before 2022, but not placed in service before 2024.

We estimate total solar-related capital expenditures for projects during fiscal 2018 to be between $132 million and $140 million. There were no commercial projects placed into service during the three months ended December 31, 2017 or 2016.

During fiscal 2017, Clean Energy Ventures entered into sale-leaseback arrangements for two of its commercial solar projects, for which the ITCs and other tax benefits associated with these solar projects were transferred to the buyer. Clean Energy Ventures expects to utilize sale-leaseback arrangements, based on market conditions, as an option to finance its commercial solar projects during fiscal 2018.

As part of its solar investment portfolio, Clean Energy Ventures operates a residential solar program, The Sunlight Advantage®, that provides qualifying homeowners the opportunity to have a solar system installed at their home with no installation or maintenance expenses. Clean Energy Ventures owns, operates and maintains the system over the life of the contract in exchange for monthly lease payments. Clean Energy Ventures' residential solar leasing program installed approximately 1.8 MW of capacity on 191 homes, and 2.8 MW of capacity on 314 homes during the three months ended December 31, 2017 and 2016, respectively.

Once a solar installation has received the proper certifications and commences operations, each MWh of electricity produced creates an SREC that represents the renewable energy attribute of the solar-electricity generated that can be sold to third parties, predominantly load-serving entities that are required to comply with the solar requirements under New Jersey's renewable portfolio standard. SREC activity consisted of the following:

	Three Months Ended December 31,	
	2017	2016
Inventory balance as of October 1,	48,357	24,135
SRECs generated	53,568	41,443
SRECs delivered	(29,680)	(10,319)
Inventory balance as of December 31,	72,245	55,259

41

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Clean Energy Ventures hedges a portion of its expected SREC production through the use of forward sales contracts. The following table reflects the hedged percentage of SREC inventory and projected SREC production related to its in-service commercial and residential assets:

Energy Year [1]	Percent of SRECs Hedged
2018	94%
2019	86%
2020	32%

(1) Energy years are compliance periods for New Jersey's renewable portfolio standard that run from June 1 to May 31.

There are no direct costs associated with the production of SRECs/RECs by our solar and wind assets. All related costs are included as a component of O&M expenses on the Unaudited Condensed Consolidated Statements of Operations, including such expenses as facility maintenance and various fees.

Onshore Wind

Clean Energy Ventures has invested in small to mid-size onshore wind projects that fit its investment profile and had a total of 126.6 MW of wind capacity as of December 31, 2017. The wind projects are eligible for PTCs for a 10-year period following commencement of operations and have PPAs of various terms in place, which typically govern the sale of energy, capacity and/or renewable energy credits.

Clean Energy Ventures' investments are subject to a variety of factors, such as timing of construction schedules, permitting and regulatory processes, volatility of energy prices, the ability to secure PPAs, delays related to electric grid interconnection, which can affect our ability to commence operations on a timely basis or, at all, economic trends, the ability to access capital or allocation of capital to other investments or business opportunities and other unforeseen events. Solar projects not placed in service, as originally planned prior to the end of a reporting period, may result in a failure to qualify for ITCs. Further, changes in prices on the unhedged portion of SREC production could have a significant adverse impact on earnings with some offset expected from higher wind energy market prices due to the PTC phase out and/or improved efficiencies from lower costs for related turbine technology.

Wind projects for which construction of a facility begins after December 31, 2016 through December 31, 2019, will be subject to reduced PTCs, and could have a significant adverse impact on 10 years of forward earnings. PTCs are being be phased out from 100 percent in 2016 to 80 percent in 2017, 60 percent in 2018, 40 percent in 2019 and zero thereafter.

Operating Results

Clean Energy Ventures' financial results are summarized as follows:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Operating revenues	$13,996	$7,567

Operating expenses		
Operation and maintenance	5,192	4,404
Depreciation and amortization	8,935	7,041
Other taxes	404	415
Total operating expenses	14,531	11,860
Operating loss	(535)	(4,293)
Other income, net	24	(72)
Interest expense, net	4,208	3,324
Income tax benefit	(73,988)	(11,887)
Net income	$69,269	$4,198

42

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Operating Revenues

Operating revenues increased $6.4 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to higher SREC sales. SRECs generated increased 29.3 percent and the average SREC sales price was $231 and $241 during the three months ended December 31, 2017, and 2016, respectively.

Operation and Maintenance Expense

O&M expense increased $788,000 during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to additional maintenance costs associated with wind and solar projects placed in service.

Depreciation Expense

Depreciation expense increased $1.9 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, as a result of increases in solar capital additions.

Income Tax (Benefit)

Income tax benefit increased $62.1 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to an income tax benefit of $62.7 million associated with the Tax Act, which caused a revaluation of the deferred tax liability related to the book versus tax differences in depreciation calculated on property related items.

Net Income

Net income increased $65.1 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to the increased income tax benefit, as previously discussed.

Non-GAAP Financial Measures

Management of the Company uses NFE, a non-GAAP financial measure, when evaluating the operating results of Clean Energy Ventures. GAAP requires us, during the interim periods, to estimate our annual effective tax rate and use this rate to calculate the year-to-date tax provision. We also determine an annual estimated effective tax rate for NFE purposes and calculate a quarterly tax adjustment based on the differences between our forecasted net income and our forecasted NFE for the fiscal year. This adjustment is applied to Clean Energy Ventures, as such adjustment is primarily related to tax credits generated by Clean Energy Ventures. Since this adjustment is made to reflect the forecasted tax rate, no adjustment is needed at year end. Accordingly, for NFE purposes, the annual estimated effective tax rate for fiscal 2018 is 16.3 percent and 14.7 percent for fiscal 2017.

Since the annual estimated effective tax rate is based on certain forecasted assumptions, including estimates surrounding completion of projects, the rate and resulting NFE are subject to change. The details of such tax adjustments can be found in the table below. Non-GAAP financial measures are not in accordance with, or an

alternative to GAAP, and should be considered in addition to, and not as a substitute for the comparable GAAP measure. A reconciliation of Clean Energy Ventures' net income, the most directly comparable GAAP financial measure to NFE is as follows:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Net income	$69,269	$4,198
Add:		
Net income to NFE tax adjustment	1,981	(1,356)
Net financial earnings	$71,250	$2,842

43

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Energy Services Segment

Overview

Energy Services markets and sells natural gas to wholesale and retail customers and manages natural gas storage and transportation assets throughout major market areas across North America. Energy Services maintains a strategic portfolio of natural gas storage and transportation contracts that it utilizes in conjunction with its market expertise to provide service and value to its customers. Availability of these storage and transportation contracts allows Energy Services to generate market opportunities by capturing price differentials over specific time horizons and between geographic market locations.

Energy Services also provides management of storage and transportation assets for natural gas producers and regulated utilities. These management transactions typically involve the release of producer/utility owned storage and/or transportation capacity in combination with either an obligation to purchase and/or deliver physical natural gas. In addition to the contractual purchase and/or sale of physical natural gas, Energy Services generates or pays fee-based margin in exchange for its active management and may provide the producer and/or utility with additional margin based on actual results.

In conjunction with the active management of these contracts, Energy Services generates financial margin by identifying market opportunities and simultaneously entering into natural gas purchase/sale, storage or transportation contracts and financial derivative contracts. In cases where storage is utilized to fulfill these contracts, these forecast sales and/or purchases are economically hedged through the use of financial derivative contracts. The financial derivative contracts consist primarily of exchange-traded futures, options and swap contracts, and are frequently used to lock in anticipated transactional cash flows and to help manage volatility in natural gas market prices. Generally, when its storage and transportation contracts are exposed to periods of increased market volatility, Energy Services is able to implement strategies that allow them to capture margin by improving the respective time or geographic spreads on a forward basis.

On July 27, 2017, Energy Services acquired certain retail and wholesale natural gas energy contract assets from Talen. The acquisition included sales agreements with large commercial and industrial retail customers in Delaware, Maryland, New Jersey and Pennsylvania, pipeline and storage capacity agreements on various pipelines and various wholesale transportation contracts.

Energy Services accounts for its physical commodity contracts and its financial derivative instruments at fair value on the Unaudited Condensed Consolidated Balance Sheets. Changes in the fair value of physical commodity contracts and financial derivative instruments are included in earnings as a component of operating revenue or gas purchases on the Unaudited Condensed Consolidated Statements of Operations. Volatility in reported net income at Energy Services can occur over periods of time due to changes in the fair value of derivatives, as well as timing differences related to certain transactions. Unrealized gains and losses can fluctuate as a result of changes in the price of natural gas, SRECs and foreign currency from the original transaction price. Volatility in earnings can also occur as a result of timing differences between the settlement of financial derivatives and the sale of the underlying physical commodity. For example, when a financial instrument settles and the physical natural gas is injected into inventory, the realized gains and losses associated with the financial instrument are recognized in earnings. However, the gains and losses associated with the physical natural gas are not recognized in earnings until the natural gas inventory is withdrawn

from storage and sold, at which time Energy Services realizes the entire margin on the transaction.

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Operating Results

Energy Services' financial results are summarized as follows:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Operating revenues [(1)]	$477,981	$337,181
Operating expenses		
Gas purchases (including demand charges [(2)(3)])	446,210	339,087
Operation and maintenance	4,420	5,018
Depreciation and amortization	14	16
Other taxes	1,217	455
Total operating expenses	451,861	344,576
Operating income (loss)	26,120	(7,395)
Interest expense, net	1,257	571
Income tax provision (benefit)	13,743	(3,176)
Net income (loss)	$11,120	$(4,790)

(1) Includes related party transactions of approximately $5.8 million and $1.7 million for the three months ended December 31, 2017 and 2016, respectively, which is eliminated in consolidation.
(2) Costs associated with pipeline and storage capacity that are expensed over the term of the related contracts, which generally varies from less than one year to ten years.
(3) Includes related party transactions of approximately $1.1 million and $1.2 million for the three months ended December 31, 2017 and 2016, respectively, a portion of which is eliminated in consolidation.

Energy Services' portfolio of financial derivative instruments are composed of:

	Three Months Ended December 31,	
(in Bcf)	2017	2016
Net short futures contracts	33.4	76.4
Net long options	—	0.5

Operating Revenues and Gas Purchases

Operating revenues increased $140.8 million and gas purchases increased $107.1 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to an approximate 29.2 percent increase in the average price of natural gas and a 29.2 percent increase in sales volumes due to the colder weather in December 2017.

Future results at Energy Services are contingent upon natural gas market price volatility driven by variations in both the supply and demand balances caused by weather and other factors. As a result, variations in weather patterns in the

key market areas served may affect earnings during the fiscal year. Changes in market fundamentals such as an increase in supply and decrease in demand due to milder temperatures, and reduced volatility can negatively impact Energy Services' earnings. See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Natural Gas Distribution Segment for Tetco M-3 Daily Prices, which illustrates the daily natural gas prices in the Northeast market region.

Income Tax Provision

Income tax provision increased $16.9 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to higher income tax expense associated with the Tax Act in the amount of $9.1 million and an increase in income tax expense related to the increased operating income, partially offset by the lower effective tax rate as a result of the new tax legislation.

Net Income

Net income increased $15.9 million during the three months ended December 31, 2017, compared with the three months ended December 31, 2016, due primarily to the increase in operating income, partially offset by an increase in income tax expense, as previously discussed.

New Jersey Resources Corporation
Part I

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Non-GAAP Financial Measures

Management uses financial margin and NFE, non-GAAP financial measures, when evaluating the operating results of Energy Services. Financial margin and NFE are based on removing timing differences associated with certain derivative instruments, as discussed above. There is a related tax effect on current and deferred income tax expense corresponding with NFE. Also included in the tax effect during the three month ended December 31, 2017, are the impacts of the Tax Act and resulting revaluation of the deferred income taxes that arose from derivative and hedging activity as measured under NFE. The revaluation caused the effective tax rate on reconciling items to differ from the statutory rate in effect for the quarter.

Management views these measures as representative of the overall expected economic result and uses these measures to compare Energy Services' results against established benchmarks and earnings targets as these measures eliminate the impact of volatility on GAAP earnings as a result of timing differences associated with the settlement of derivative instruments. To the extent that there are unanticipated impacts from changes in the market value related to the effectiveness of economic hedges, Energy Services' actual non-GAAP results can differ from the results anticipated at the outset of the transaction. Non-GAAP financial measures are not in accordance with, or an alternative to, GAAP and should be considered in addition to, and not as a substitute for, the comparable GAAP measure.

When Energy Services reconciles the most directly comparable GAAP measure to both financial margin and NFE, the current period unrealized gains and losses on derivatives are excluded as a reconciling item. Financial margin and NFE also exclude the effects of economic hedging of the value of our natural gas in storage and, therefore, only include realized gains and losses related to natural gas withdrawn from storage, effectively matching the full earnings effects of the derivatives with realized margins on the related physical gas flows.

Financial Margin

The following table is a computation of Energy Services' financial margin:

	Three Months Ended December 31,	
(Thousands)	2017	2016
Operating revenues [1]	$477,981	$337,181
Less: Gas purchases	446,210	339,087
Add:		
Unrealized loss on derivative instruments and related transactions	33,873	