

RGC RESOURCES INC  
Form 10-Q  
May 07, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For Quarterly Period Ended March 31, 2015  
Commission File Number 000-26591

RGC Resources, Inc.(Exact name of Registrant as  
Specified in its Charter)

VIRGINIA 54-1909697  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

519 Kimball Ave., N.E., Roanoke, VA 24016  
(Address of Principal Executive Offices) (Zip Code)

(540) 777-4427  
(Registrant's Telephone Number, Including Area Code)

None  
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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  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 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 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.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class Outstanding at April 30, 2015  
Common Stock, \$5 Par Value 4,728,527



RGC RESOURCES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

|   | Unaudited<br>March 31,<br>2015 | September 30,<br>2014 |
|---|--------------------------------|-----------------------|
| <b>ASSETS</b>   |                                |                       |
| <b>CURRENT ASSETS:</b>  |                                |                       |
| Cash and cash equivalents   | \$878,305                      | \$849,757             |
| Accounts receivable (less allowance for uncollectibles of \$334,953 and \$70,747, respectively) | 11,072,475                     | 3,730,173             |
| Materials and supplies  | 911,797                        | 893,672               |
| Gas in storage  | 2,879,186                      | 11,402,990            |
| Prepaid income taxes  | —                              | 1,144,214             |
| Deferred income taxes   | 3,523,037                      | 1,704,320             |
| Under-recovery of gas costs   | —                              | 180,831               |
| Other   | 1,524,227                      | 1,104,660             |
| Total current assets  | 20,789,027                     | 21,010,617            |
| <b>UTILITY PROPERTY:</b>  |                                |                       |
| In service  | 162,952,273                    | 155,360,200           |
| Accumulated depreciation and amortization   | (52,006,183)                   | (50,645,642)          |
| In service, net   | 110,946,090                    | 104,714,558           |
| Construction work in progress   | 2,315,142                      | 4,029,019             |
| Utility plant, net  | 113,261,232                    | 108,743,577           |
| <b>OTHER ASSETS:</b>  |                                |                       |
| Regulatory assets   | 9,281,891                      | 9,273,389             |
| Other   | 306,765                        | 293,139               |
| Total other assets  | 9,588,656                      | 9,566,528             |
| <b>TOTAL ASSETS</b>   | <b>\$143,638,915</b>           | <b>\$139,320,722</b>  |

See notes to condensed consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

|   | Unaudited<br>March 31,<br>2015 | September 30,<br>2014 |
|---|--------------------------------|-----------------------|
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                |                       |
| <b>CURRENT LIABILITIES:</b>   |                                |                       |
| Borrowings under line-of-credit   | \$2,591,698                    | \$9,045,050           |
| Dividends payable   | 910,241                        | 873,326               |
| Accounts payable  | 4,519,219                      | 5,367,299             |
| Customer credit balances  | 432,345                        | 1,373,927             |
| Income taxes payable  | 1,214,580                      | —                     |
| Customer deposits   | 1,712,311                      | 1,492,150             |
| Accrued expenses  | 2,872,870                      | 2,200,882             |
| Over-recovery of gas costs  | 5,188,049                      | —                     |
| Total current liabilities   | 19,441,313                     | 20,352,634            |
| <b>LONG-TERM DEBT</b>   | <b>30,500,000</b>              | <b>30,500,000</b>     |
| <b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>  |                                |                       |
| Asset retirement obligations  | 4,897,831                      | 4,802,015             |
| Regulatory cost of retirement obligations   | 8,891,963                      | 8,575,147             |
| Benefit plan liabilities  | 8,054,872                      | 8,459,436             |
| Deferred income taxes   | 16,710,482                     | 14,610,643            |
| Total deferred credits and other liabilities  | 38,555,148                     | 36,447,241            |
| <b>STOCKHOLDERS' EQUITY:</b>  |                                |                       |
| Common stock, \$5 par value; authorized 10,000,000 shares; issued and outstanding 4,728,152 and 4,720,378, respectively | 23,640,760                     | 23,601,890            |
| Preferred stock, no par, authorized 5,000,000 shares; no shares issued and outstanding                                  | —                              | —                     |
| Capital in excess of par value  | 8,416,860                      | 8,237,228             |
| Retained earnings   | 24,205,480                     | 21,321,055            |
| Accumulated other comprehensive loss  | (1,120,646)                    | (1,139,326)           |
| Total stockholders' equity  | 55,142,454                     | 52,020,847            |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>   | <b>\$143,638,915</b>           | <b>\$139,320,722</b>  |

RGC RESOURCES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 FOR THE THREE-MONTH AND SIX-MONTH PERIODS ENDED MARCH 31, 2015 AND 2014  
 UNAUDITED

|  | Three Months Ended March 31, |                    | Six Months Ended March 31, |                    |
|--|------------------------------|--------------------|----------------------------|--------------------|
|  | 2015                         | 2014               | 2015                       | 2014               |
| <b>OPERATING REVENUES:</b>                 |                              |                    |                            |                    |
| Gas utilities                              | \$26,069,150                 | \$32,469,907       | \$47,067,428               | \$52,230,894       |
| Other                                      | 362,579                      | 230,058            | 614,366                    | 480,265            |
| Total operating revenues                   | 26,431,729                   | 32,699,965         | 47,681,794                 | 52,711,159         |
| <b>COST OF SALES:</b>                      |                              |                    |                            |                    |
| Gas utilities                              | 16,016,661                   | 22,430,550         | 28,531,255                 | 34,102,544         |
| Other                                      | 201,298                      | 108,290            | 314,626                    | 244,498            |
| Total cost of sales                        | 16,217,959                   | 22,538,840         | 28,845,881                 | 34,347,042         |
| <b>GROSS MARGIN</b>                        | <b>10,213,770</b>            | <b>10,161,125</b>  | <b>18,835,913</b>          | <b>18,364,117</b>  |
| <b>OTHER OPERATING EXPENSES:</b>           |                              |                    |                            |                    |
| Operations and maintenance                 | 3,623,627                    | 3,424,140          | 7,048,279                  | 6,767,490          |
| General taxes                              | 429,045                      | 417,164            | 834,555                    | 805,361            |
| Depreciation and amortization              | 1,281,629                    | 1,198,799          | 2,559,258                  | 2,397,598          |
| Total other operating expenses             | 5,334,301                    | 5,040,103          | 10,442,092                 | 9,970,449          |
| <b>OPERATING INCOME</b>                    | <b>4,879,469</b>             | <b>5,121,022</b>   | <b>8,393,821</b>           | <b>8,393,668</b>   |
| <b>OTHER EXPENSE, Net</b>                  | <b>(6,934</b>                | <b>) (45,756</b>   | <b>) (12,813</b>           | <b>) (70,891</b>   |
| <b>INTEREST EXPENSE</b>                    | <b>385,162</b>               | <b>455,657</b>     | <b>782,229</b>             | <b>920,110</b>     |
| <b>INCOME BEFORE INCOME TAXES</b>          | <b>4,487,373</b>             | <b>4,619,609</b>   | <b>7,598,779</b>           | <b>7,402,667</b>   |
| <b>INCOME TAX EXPENSE</b>                  | <b>1,708,029</b>             | <b>1,772,814</b>   | <b>2,895,059</b>           | <b>2,833,084</b>   |
| <b>NET INCOME</b>                          | <b>\$2,779,344</b>           | <b>\$2,846,795</b> | <b>\$4,703,720</b>         | <b>\$4,569,583</b> |
| <b>BASIC EARNINGS PER COMMON SHARE</b>     | <b>\$0.59</b>                | <b>\$0.60</b>      | <b>\$1.00</b>              | <b>\$0.97</b>      |
| <b>DILUTED EARNINGS PER COMMON SHARE</b>   | <b>\$0.59</b>                | <b>\$0.60</b>      | <b>\$1.00</b>              | <b>\$0.97</b>      |
| <b>DIVIDENDS DECLARED PER COMMON SHARE</b> | <b>\$0.1925</b>              | <b>\$0.1850</b>    | <b>\$0.385</b>             | <b>\$0.370</b>     |

See notes to condensed consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 FOR THE THREE-MONTH AND SIX-MONTH PERIODS ENDED MARCH 31, 2015 AND 2014  
 UNAUDITED

|   | Three Months Ended March 31, |             | Six Months Ended March 31, |             |
|---|------------------------------|-------------|----------------------------|-------------|
|   | 2015                         | 2014        | 2015                       | 2014        |
| NET INCOME                              | \$2,779,344                  | \$2,846,795 | \$4,703,720                | \$4,569,583 |
| Other comprehensive income, net of tax: |                              |             |                            |             |
| Interest rate SWAPs                     | —                            | 132,267     | —                          | 266,663     |
| Defined benefit plans                   | 9,340                        | 6,490       | 18,680                     | 12,980      |
| OTHER COMPREHENSIVE INCOME, NET OF TAX  | 9,340                        | 138,757     | 18,680                     | 279,643     |
| COMPREHENSIVE INCOME                    | \$2,788,684                  | \$2,985,552 | \$4,722,400                | \$4,849,226 |

See notes to condensed consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE SIX-MONTH PERIODS  
ENDED MARCH 31, 2015 AND 2014  
UNAUDITED

|   | Six Months Ended March 31, |                    |
|---|----------------------------|--------------------|
|   | 2015                       | 2014               |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                            |                    |
| Net income  | \$4,703,720                | \$4,569,583        |
| Adjustments to reconcile net income to net cash provided by operating activities:                                 |                            |                    |
| Depreciation and amortization   | 2,615,387                  | 2,494,521          |
| Cost of removal of utility plant, net   | (184,255                   | ) (201,371 )       |
| Stock option grants   | 55,760                     | 50,208             |
| Changes in assets and liabilities which used cash, exclusive of changes and noncash transactions shown separately | 7,707,551                  | 2,781,248          |
| Net cash provided by operating activities   | 14,898,163                 | 9,694,189          |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                            |                    |
| Additions to utility plant and nonutility property  | (6,801,151                 | ) (7,203,480 )     |
| Proceeds from disposal of equipment   | 4,526                      | 8,172              |
| Net cash used in investing activities   | (6,796,625                 | ) (7,195,308 )     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                            |                    |
| Borrowings under line-of-credit agreement   | 21,587,310                 | 13,893,656         |
| Repayments under line-of-credit agreement   | (28,040,662                | ) (13,893,656 )    |
| Proceeds from issuance of stock (7,774 and 7,578 shares, respectively)  | 162,742                    | 145,258            |
| Cash dividends paid   | (1,782,380                 | ) (1,719,339 )     |
| Net cash used in financing activities   | (8,072,990                 | ) (1,574,081 )     |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>  | <b>28,548</b>              | <b>924,800</b>     |
| <b>BEGINNING CASH AND CASH EQUIVALENTS</b>  | <b>849,757</b>             | <b>2,846,224</b>   |
| <b>ENDING CASH AND CASH EQUIVALENTS</b>   | <b>\$878,305</b>           | <b>\$3,771,024</b> |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>  |                            |                    |
| Interest paid   | \$336,196                  | \$899,845          |
| Income taxes paid   | 266,573                    | 1,350,000          |

See notes to condensed consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

1. Basis of Presentation

RGC Resources, Inc. is an energy services company primarily engaged in the sale and distribution of natural gas. The consolidated financial statements include the accounts of RGC Resources, Inc. and its wholly owned subsidiaries (“Resources” or the “Company”): Roanoke Gas Company; Diversified Energy Company; and RGC Ventures of Virginia, Inc.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly Resources financial position as of March 31, 2015 and the results of its operations, cash flows and comprehensive income for the three months and six months ended March 31, 2015 and 2014. The results of operations for the three months and six months ended March 31, 2015 are not indicative of the results to be expected for the fiscal year ending September 30, 2015 as quarterly earnings are affected by the highly seasonal nature of the business and weather conditions generally result in greater earnings during the winter months.

The unaudited condensed consolidated interim financial statements and condensed notes are presented as permitted under the rules and regulations of the Securities and Exchange Commission. Pursuant to those rules, certain information and note disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, although the Company believes that the disclosures made are adequate to make the information not misleading. Therefore, the condensed consolidated financial statements and condensed notes should be read in conjunction with the financial statements and notes contained in the Company’s Form 10-K for the year ended September 30, 2014. The September 30, 2014 balance sheet was included in the Company’s audited financial statements included in Form 10-K.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company’s significant accounting policies are described in Note 1 to the consolidated financial statements in Form 10-K for the year ended September 30, 2014. Newly adopted and newly issued accounting standards are discussed below.

Recently Issued Accounting Standards

In May 2014, the FASB issued guidance under FASB ASC No. 606 - Revenue from Contracts with Customers that affects any entity that enters into contracts with customers for the transfer of goods or services or transfer of non-financial assets. This guidance supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (1) identify the contract with the customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when, or as, the entity satisfies the performance obligation. The new guidance is effective for the Company for the annual reporting period ending September 30, 2018 and interim periods within that annual period. Early application is not permitted. In March 2015, the FASB issued an exposure draft to provide for a one-year deferral of the effective date of the new revenue standard. If approved, the new guidance would be effective for the Company for the annual reporting period ending September 30, 2019 and interim periods within that year. Management has not completed its evaluation of the new guidance. However, the Company does not currently expect the new guidance to have a material effect on its financial position, results of operations or cash flows.



In April 2015, the FASB issued Accounting Standards Update (ASU) 2015-03, Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The Company currently recognizes debt issuance costs in assets and amortizes those costs over the term of the debt. This guidance is effective for the Company for the annual reporting period ending September 30, 2017 and interim periods within that annual period. Early application is permitted. The Company anticipates adopting the ASU in the current fiscal year. The adoption of this ASU is not expected to have an effect on the Company's results of operations or cash flows; however, the unamortized balance of debt issuance costs will be reclassified from assets to an offset against long-term debt.

Other accounting standards have been issued by the FASB or other standard-setting bodies that are not currently applicable to the Company or are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

## 2. Rates and Regulatory Matters

The State Corporation Commission of Virginia ("SCC") exercises regulatory authority over the natural gas operations of Roanoke Gas. Such regulation encompasses terms, conditions, and rates to be charged to customers for natural gas service; safety standards; extension of service; and accounting and depreciation.

On June 25, 2014, the SCC approved the Company's application requesting approval to extend its authority to incur short-term indebtedness of up to \$30,000,000 and to issue up to \$60,000,000 in long-term debt securities. The short-term indebtedness authority allows the Company to continue to access its line-of-credit to provide seasonal funding of its working capital needs as well as provide temporary bridge financing for its capital expenditures. The authorization extends through September 30, 2019.

Roanoke Gas Company has had in place a weather normalization adjustment tariff ("WNA") based on a weather measurement band around the most recent 30-year temperature average. Prior to April 2014, the WNA provided for a weather band of 3% above or below the 30-year temperature average. Effective with the WNA period that began April 1, 2014, the 3% weather band was removed from the WNA calculation, which now results in either a recovery or refund of revenues due to weather variations from the 30-year average. For the three months ended March 31, 2015 and March 31, 2014, weather was colder than the 30-year average resulting in a reduction in revenue of approximately \$734,000 and \$719,000, respectively. The Company applied the provisions of FASB ASC No. 980, Regulated Operations, in recording the effect of the WNA adjustment on revenue.

## 3. Short-Term Debt

The Company entered into a new unsecured line-of-credit agreement dated March 31, 2015. The new agreement maintains the same variable interest rate based on 30-day LIBOR plus 100 basis points and availability fee of 15 basis points as the expiring agreement. The agreement also includes multi-tiered borrowing limits to accommodate seasonal borrowing demands and minimize borrowing costs. The Company's total available borrowing limits during the term of the new line-of-credit agreement range from \$6,000,000 to \$24,000,000. The line-of-credit agreement will expire March 31, 2016, unless extended. The Company anticipates being able to extend or replace the credit line upon expiration. As of March 31, 2015, the Company had \$2,591,698 outstanding under its line-of-credit agreement.

## 4. Derivatives and Hedging

The Company's risk management policy allows management to enter into derivatives for the purpose of managing the commodity and financial market risks of its business operations. The Company's risk management policy specifically prohibits the use of derivatives for speculative purposes. The key market risks that the Company seeks to hedge include the price of natural gas and the cost of borrowed funds.

The Company previously had two interest rate swaps associated with its variable rate notes. These swaps were terminated when the Company refinanced the corresponding notes on September 18, 2014. The Company has no derivative instruments outstanding at March 31, 2015.

## 5. Other Comprehensive Income

A summary of other comprehensive income and loss is provided below:

## RGC RESOURCES, INC. AND SUBSIDIARIES

|   | Before-Tax<br>Amount | Tax<br>(Expense)<br>or Benefit | Net-of-Tax<br>Amount |
|---|----------------------|--------------------------------|----------------------|
| Three Months Ended March 31, 2015               |                      |                                |                      |
| Defined benefit plans:                          |                      |                                |                      |
| Amortization of actuarial losses                | \$ 15,055            | \$ (5,715 )                    | \$ 9,340             |
| Other comprehensive income                      | \$ 15,055            | \$ (5,715 )                    | \$ 9,340             |
| Three Months Ended March 31, 2014               |                      |                                |                      |
| Interest rate swaps:                            |                      |                                |                      |
| Unrealized losses                               | \$(23,831 )          | \$ 9,047                       | \$(14,784 )          |
| Transfer of realized losses to interest expense | 237,026              | (89,975 )                      | 147,051              |
| Net interest rate SWAPs                         | 213,195              | (80,928 )                      | 132,267              |
| Defined benefit plans:                          |                      |                                |                      |
| Amortization of actuarial losses                | 10,461               | (3,971 )                       | 6,490                |
| Other comprehensive income                      | \$ 223,656           | \$ (84,899 )                   | \$ 138,757           |

|  | Before-Tax<br>Amount | Tax<br>(Expense)<br>or Benefit | Net-of-Tax<br>Amount |
|--|----------------------|--------------------------------|----------------------|
| Six Months Ended March 31, 2015  |                      |                                |                      |
| Defined benefit plans:   |                      |                                |                      |
| Amortization of actuarial losses   | 30,110               | (11,430 )                      | 18,680               |
| Other comprehensive income   | \$ 30,110            | \$ (11,430 )                   | \$ 18,680            |
| Six Months Ended March 31, 2014  |                      |                                |                      |
| Interest rate swaps:   |                      |                                |                      |
| Unrealized losses  | \$(48,919 )          | \$ 18,570                      | \$(30,349 )          |
| Transfer of realized losses to interest expense  | 478,742              | (181,730 )                     | 297,012              |
| Net interest rate SWAPs  | 429,823              | (163,160 )                     | 266,663              |
| Defined benefit plans:   |                      |                                |                      |
| Amortization of actuarial losses   | 20,922               | (7,942 )                       | 12,980               |
| Other comprehensive income   | \$ 450,745           | \$ (171,102 )                  | \$ 279,643           |
| The amortization of actuarial losses is included as a component of net periodic pension and postretirement benefit cost in operations and maintenance expense. |                      |                                |                      |

## Reconciliation of Other Accumulated Comprehensive Income (Loss)

|                               |  |
|-------------------------------|--|
|                               | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) |
| Balance at September 30, 2014 | \$(1,139,326 )   |
| Other comprehensive income    | 18,680   |
| Balance at March 31, 2015     | \$(1,120,646 )   |

## 6. Earnings Per Share

Basic earnings per common share for the three months and six months ended March 31, 2015 and 2014 were calculated by dividing net income by the weighted average common shares outstanding during the period. Diluted earnings per common share were calculated by dividing net income by the weighted average common shares outstanding during the period plus potential dilutive common shares. A reconciliation of basic and diluted earnings per share is presented below:

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## RGC RESOURCES, INC. AND SUBSIDIARIES

|                                     | Three Months Ended March 31, |             | Six Months Ended March 31, |             |
|-------------------------------------|------------------------------|-------------|----------------------------|-------------|
|                                     | 2015                         | 2014        | 2015                       | 2014        |
| Net Income                          | \$2,779,344                  | \$2,846,795 | \$4,703,720                | \$4,569,583 |
| Weighted average common shares      | 4,724,548                    | 4,713,567   | 4,723,002                  | 4,712,000   |
| Effect of dilutive securities:      |                              |             |                            |             |
| Options to purchase common stock    | 4,149                        | 416         | 4,128                      | 258         |
| Diluted average common shares       | 4,728,697                    | 4,713,983   | 4,727,130                  | 4,712,258   |
| Earnings Per Share of Common Stock: |                              |             |                            |             |
| Basic                               | \$0.59                       | \$0.60      | \$1.00                     | \$0.97      |
| Diluted                             | \$0.59                       | \$0.60      | \$1.00                     | \$0.97      |

## 7. Commitments and Contingencies

Roanoke Gas currently holds the only franchises and/or certificates of public convenience and necessity to distribute natural gas in its service area. These franchises are effective through January 1, 2016. Certificates of public convenience and necessity in Virginia are exclusive and are intended for perpetual duration.

Due to the nature of the natural gas distribution business, the Company has entered into agreements with both suppliers and pipelines for natural gas commodity purchases, storage capacity and pipeline delivery capacity. The Company obtains most of its regulated natural gas supply from an asset manager. The Company uses an asset manager to assist in optimizing the use of its transportation, storage rights, and gas supply in order to provide a secure and reliable source of natural gas to its customers. The Company also has storage and pipeline capacity contracts to store and deliver natural gas to the Company's distribution system. Roanoke Gas is served directly by two primary pipelines. These two pipelines deliver all of the natural gas supplied to the Company's customers. Depending on weather conditions and the level of customer demand, failure of one or both of these transmission pipelines could have a major adverse impact on the Company.

## 8. Employee Benefit Plans

The Company has both a defined benefit pension plan (the "pension plan") and a postretirement benefit plan (the "postretirement plan"). The pension plan covers substantially all of the Company's employees and provides retirement income based on years of service and employee compensation. The postretirement plan provides certain health care and supplemental life insurance benefits to retired employees who meet specific age and service requirements. Net pension plan and postretirement plan expense recorded by the Company is detailed as follows:

|  | Three Months Ended<br>March 31, |            | Six Months Ended<br>March 31, |            |
|--|---------------------------------|------------|-------------------------------|------------|
|  | 2015                            | 2014       | 2015                          | 2014       |
| Components of net periodic pension cost:   |                                 |            |                               |            |
| Service cost                               | \$163,696                       | \$138,323  | \$327,392                     | \$276,646  |
| Interest cost                              | 256,477                         | 255,076    | 512,954                       | 510,152    |
| Expected return on plan assets             | (360,212 )                      | (328,089 ) | (720,424 )                    | (656,178 ) |
| Recognized loss                            | 64,345                          | 34,099     | 128,690                       | 68,198     |
| Net periodic pension cost                  | \$124,306                       | \$99,409   | \$248,612                     | \$198,818  |
|  |                                 |            |                               |            |
|  | Three Months Ended<br>March 31, |            | Six Months Ended<br>March 31, |            |
|  | 2015                            | 2014       | 2015                          | 2014       |
| Components of postretirement benefit cost: |                                 |            |                               |            |
| Service cost                               | \$41,895                        | \$42,159   | \$83,790                      | \$84,318   |
| Interest cost                              | 150,024                         | 150,671    | 300,048                       | 301,342    |

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|                                 |            |            |            |            |
|---------------------------------|------------|------------|------------|------------|
| Expected return on plan assets  | (129,164 ) | (124,119 ) | (258,328 ) | (248,238 ) |
| Recognized loss                 | 49,265     | 22,379     | 98,530     | 44,758     |
| Net postretirement benefit cost | \$112,020  | \$91,090   | \$224,040  | \$182,180  |

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## RGC RESOURCES, INC. AND SUBSIDIARIES

The Company contributed \$400,000 to its pension plan and \$250,000 to its postretirement medical plan during the six-month period ended March 31, 2015. The Company currently expects to contribute an additional \$400,000 to its pension plan and \$250,000 to its postretirement benefit plan prior to the end of its fiscal year.

## 9. Fair Value Measurements

FASB ASC No. 820, Fair Value Measurements and Disclosures, established a fair value hierarchy that prioritizes each input to the valuation method used to measure fair value of financial and nonfinancial assets and liabilities that are measured and reported on a fair value basis into one of the following three broad levels:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 – Inputs other than quoted prices in Level 1 that are either for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Unobservable inputs for the asset or liability where there is little, if any, market activity for the asset or liability at the measurement date.

The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3).

The following table summarizes the Company's financial assets and liabilities that are measured at fair value on a recurring basis as required by existing guidance and the fair value measurements by level within the fair value hierarchy as of March 31, 2015 and September 30, 2014:

|                       | Fair Value | Fair Value Measurements - March 31, 2015  |   |   |
|-----------------------|------------|---|---|---|
|                       |            | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Liabilities:          |            |   |   |   |
| Natural gas purchases | \$728,415  | \$—                                       | \$728,415                                     | \$—                                       |
| Total                 | \$728,415  | \$—                                       | \$728,415                                     | \$—                                       |

|                       | Fair Value | Fair Value Measurements - September 30, 2014 |   |   |
|-----------------------|------------|--|---|---|
|                       |            | Quoted Prices in Active Markets (Level 1)    | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Liabilities:          |            |  |   |   |
| Natural gas purchases | \$795,019  | \$—  | \$795,019                                     | \$—                                       |
| Total                 | \$795,019  | \$—  | \$795,019                                     | \$—                                       |

Under the asset management contract, a timing difference can exist between the payment for natural gas purchases and the actual receipt of such purchases. Payments are made based on a predetermined monthly volume with the price

based on weighted average first of the month index prices corresponding to the month of the scheduled payment. At March 31, 2015 and September 30, 2014, the Company had recorded in accounts payable the estimated fair value of the liability valued at the corresponding first of month index prices for which the liability is expected to be settled.

The Company's nonfinancial assets and liabilities that are measured at fair value on a nonrecurring basis consist of its asset retirement obligations. The asset retirement obligations are measured at fair value at initial recognition based on expected future cash flows required to settle the obligation.

The carrying value of cash and cash equivalents, accounts receivable, accounts payable (with the exception of the timing difference under the asset management contract), customer credit balances and customer deposits is a reasonable estimate of fair value due to the short-term nature of these financial instruments. The following table summarizes the fair value of



## RGC RESOURCES, INC. AND SUBSIDIARIES

the Company's financial assets and liabilities that are not adjusted to fair value in the financial statements as of March 31, 2015 and September 30, 2014:

|                | Carrying Value | Fair Value Measurements - March 31, 2015  |   |   |
|----------------|----------------|---|---|---|
|                |                | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Liabilities:   |                |   |   |   |
| Long-term debt | \$30,500,000   | \$—                                       | \$—   | \$31,161,658                              |
| Total          | \$30,500,000   | \$—                                       | \$—   | \$31,161,658                              |

|                | Carrying Value | Fair Value Measurements - September 30, 2014 |   |   |
|----------------|----------------|--|---|---|
|                |                | Quoted Prices in Active Markets (Level 1)    | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Liabilities:   |                |  |   |   |
| Long-term debt | \$30,500,000   | \$—  | \$—   | \$30,622,664                              |
| Total          | \$30,500,000   | \$—  | \$—   | \$30,622,664                              |

The fair value of long-term debt is estimated by discounting the future cash flows of the debt based on current market rates and corresponding interest rate spread.

FASB ASC 825, Financial Instruments, requires disclosures regarding concentrations of credit risk from financial instruments. Cash equivalents are investments in high-grade, short-term securities (original maturity less than three months), placed with financially sound institutions. Accounts receivable are from a diverse group of customers including individuals and small and large companies in various industries. As of March 31, 2015 and September 30, 2014, no single customer accounted for more than 5% of the total accounts receivable balance. The Company maintains certain credit standards with its customers and requires a customer deposit if such evaluation warrants.

#### 10. Stock Options

On December 4, 2014, the Board of Directors granted 17,000 options to certain officers of the Company. In accordance with the Key Employee Stock Option Plan, the grant price of \$21.60 was the closing price of the Company's stock on the grant date. The options become exercisable six months from the grant date and expire after ten years from the date of issuance.

Fair value at the grant date was \$4.92 per option as calculated using the Black-Scholes option pricing model. Compensation expense will be recognized over the vesting period. Total compensation expense recognized through March 31, 2015 was \$55,760.

#### 11. Subsequent Events

The Company has evaluated subsequent events through the date the financial statements were issued. There were no items not otherwise disclosed which would have materially impacted the Company's condensed consolidated financial statements.



RGC RESOURCES, INC. AND SUBSIDIARIES

ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This report contains forward-looking statements that relate to future transactions, events or expectations. In addition, RGC Resources, Inc. (“Resources” or the “Company”) may publish forward-looking statements relating to such matters as anticipated financial performance, business prospects, technological developments, new products, research and development activities and similar matters. These statements are based on management’s current expectations and information available at the time of such statements and are believed to be reasonable and are made in good faith. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors could cause the Company’s actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company’s forward-looking statements. The risks and uncertainties that may affect the operations, performance, development and results of the Company’s business include, but are not limited to those set forth in the following discussion and within Item 1A “Risk Factors” in the Company’s 2014 Annual Report on Form 10-K. All of these factors are difficult to predict and many are beyond the Company’s control. Accordingly, while the Company believes its forward-looking statements to be reasonable, there can be no assurance that they will approximate actual experience or that the expectations derived from them will be realized. When used in the Company’s documents or news releases, the words, “anticipate,” “believe,” “intend,” “plan,” “estimate,” “expect,” “objective,” “projection,” “forecast,” “budget,” “assess” or similar words or future or conditional verbs such as “will,” “would,” “should,” “can,” “could” or “may” are intended to identify forward-looking statements.

Forward-looking statements reflect the Company’s current expectations only as of the date they are made. The Company assumes no duty to update these statements should expectations change or actual results differ from current expectations except as required by applicable laws and regulations.

The three-month and six-month earnings presented herein should not be considered as reflective of the Company’s consolidated financial results for the fiscal year ending September 30, 2015. The total revenues and margins realized during the first three months reflect higher billings due to the weather sensitive nature of the gas business.

Overview

Resources is an energy services company primarily engaged in the regulated sale and distribution of natural gas to approximately 60,000 residential, commercial and industrial customers in Roanoke, Virginia and the surrounding localities through its Roanoke Gas Company (“Roanoke Gas”) subsidiary. Natural gas service is provided at rates and for terms and conditions set by the Virginia State Corporation Commission (“SCC”).

Resources also provides certain unregulated services through Roanoke Gas and its other subsidiaries. Such unregulated operations represent less than 3% of total revenues and margin of Resources on an annual basis.

The Company’s utility operations are regulated by the SCC, which oversees the terms, conditions, and rates to be charged to customers for natural gas service, safety standards, extension of service, accounting and depreciation. The Company is also subject to federal regulation from the Department of Transportation in regard to the construction, operation, maintenance, safety and integrity of its transmission and distribution pipelines. The Federal Energy Regulatory Commission regulates the prices for the transportation and delivery of natural gas to the Company’s distribution system and underground storage services. The Company is also subject to other regulations which are not necessarily industry specific.

The SCC authorizes the rates and fees that the Company charges its customers for regulated natural gas service. The rates approved by the SCC provide for the recovery of the Company’s costs and include a provision for profit based on the Company’s authorized rate of return and the assumption of normal weather. In addition the Company has in place certain approved rate mechanisms that reduce some of the volatility in earnings associated with variations in winter weather from normal and the cost of natural gas.

Roanoke Gas has in place a weather normalization adjustment mechanism (“WNA”) based on the most recent 30-year temperature average (“normal”). Because the SCC authorizes billing rates for the utility operations of Roanoke Gas

based on normal weather, warmer than normal weather may result in the Company failing to earn its authorized rate of return. Therefore, the WNA provides the Company with a level of earnings protection when weather is warmer than normal and provides its customers with a level of protection when the weather is colder than normal. Prior to April 2014, the WNA provided a weather band of 3% above and below normal. Effective with the WNA year that began April 1, 2014, the 3% weather band was removed which now results in either a recovery or refund of revenues due to any weather variations from normal. For the three months and six months ended March 31, 2015, the Company adjusted revenues and volumetric margin down by approximately

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## RGC RESOURCES, INC. AND SUBSIDIARIES

\$734,000 and \$843,000. For the three months and six months ended March 31, 2014, the Company adjusted revenues and volumetric margins down by approximately \$719,000. For the current WNA year which began April 1, 2014, the cumulative net accrual of excess margin subject to refund was approximately \$700,000. The Company will refund the excess margin to its customers during the May billing cycle. The WNA mechanism significantly reduces the impact to the Company for the effect of weather that is different from normal.

The Company also has an approved rate structure in place that mitigates the impact of financing costs of its natural gas inventory. Under this rate structure, Roanoke Gas recognizes revenue for the financing costs, or “carrying costs,” of its investment in natural gas inventory. The carrying cost revenue factor applied to the cost of inventory is based on the Company’s weighted-average cost of capital including interest rates on short-term and long-term debt and the Company’s authorized return on equity. During times of rising gas costs and rising inventory levels, the Company recognizes revenues to offset higher financing costs associated with higher inventory balances. Conversely, during times of decreasing gas costs and lower inventory balances, the Company recognizes less inventory carrying cost (“ICC”) revenue as financing costs are lower. In addition, ICC revenues are impacted by the changes in the weighting of the components that are used to determine the weighted average cost of capital. A combination of higher average unit price of gas in storage and a 9% increase in the average volume of gas in storage during the first six months of the current fiscal year resulted in approximately \$27,000 higher ICC revenues for the quarter and \$47,000 for the current six month period compared to the same periods last year. The increase in ICC revenues was partially offset by a reduction in the carrying cost revenue factor. The weighted-average cost of capital rate declined from last year due to the refinancing of the Company's long-term debt in September and the effect of higher levels of low interest rate short-term borrowings under the Company's line-of-credit.

Generally, as investment in natural gas inventory increases so does the level of borrowing under the Company’s line-of-credit. However, as the carrying cost factor used in determining carrying cost revenues is based on the Company’s weighted-average cost of capital, carrying cost revenues do not directly correspond with incremental short-term financing costs. Therefore, when investment in inventory declines due to a reduction in commodity prices, net income will be negatively affected as carrying cost revenues decrease by a greater amount than short-term financing costs decrease. The inverse occurs when inventory costs increase.

The Company’s non-gas rates provide for the recovery of non-gas related expenses and a reasonable return to shareholders. These rates are determined based on the filing of a formal rate application with the SCC utilizing historical information including investment in natural gas facilities. Generally, investments related to extending service to new customers are recovered through the non-gas rates currently in place. The investment in replacing and upgrading existing infrastructure is not recoverable until a formal rate application is made to include the additional investment and new non-gas rates are approved. The SAVE (“Steps to Advance Virginia’s Energy”) Plan and Rider provides the Company with the ability to recover costs related to these investments on a prospective basis rather than on a historical basis. The SAVE Plan provides a mechanism to recover the related depreciation and expenses and return on rate base of the additional capital investments related to improving the Company's infrastructure until such time a formal rate application is filed to incorporate this investment in the Company's non-gas rates. As the Company did not file for an increase in the non-gas rates during the prior year and the level of capital investment continues to grow, SAVE Plan revenues have increased significantly. The Company recognized approximately \$310,000 and \$549,000 in SAVE Plan revenues for the three and six-month periods ended March 31, 2015, respectively, compared to \$108,000 and \$127,000 for the same periods last year. These SAVE revenues will be included as part of the new non-gas base rates when the Company files for a non-gas rate increase.

#### Results of Operations

##### Three Months Ended March 31, 2015:

Net income declined by \$67,451 for the quarter ended March 31, 2015, compared to the same period last year. Higher operating expenses more than offset increased SAVE Plan revenues and higher customer base charge revenues.

The tables below reflect operating revenues, volume activity and heating degree-days.



## RGC RESOURCES, INC. AND SUBSIDIARIES

|                                  | Three Months Ended<br>March 31, |              | Increase<br>(Decrease) | Percentage |    |
|----------------------------------|---------------------------------|--------------|------------------------|------------|----|
|                                  | 2015                            | 2014         |                        |            |    |
| Operating Revenues               |                                 |              |                        |            |    |
| Gas Utilities                    | \$26,069,150                    | \$32,469,907 | \$(6,400,757 )         | (20        | )% |
| Other                            | 362,579                         | 230,058      | 132,521                | 58         | %  |
| Total Operating Revenues         | \$26,431,729                    | \$32,699,965 | \$(6,268,236 )         | (19        | )% |
| Delivered Volumes                |                                 |              |                        |            |    |
| Regulated Natural Gas (DTH)      |                                 |              |                        |            |    |
| Residential and Commercial       | 3,506,983                       | 3,597,750    | (90,767 )              | (3         | )% |
| Transportation and Interruptible | 786,651                         | 837,640      | (50,989 )              | (6         | )% |
| Total Delivered Volumes          | 4,293,634                       | 4,435,390    | (141,756 )             | (3         | )% |
| Heating Degree Days (Unofficial) | 2,398                           | 2,485        | (87 )                  | (4         | )% |

Total operating revenues for the three months ended March 31, 2015, compared to the same period last year, decreased primarily due to a combination of lower natural gas costs and a reduction in total natural gas deliveries. Total natural gas deliveries declined by 3% due to a 4% decline in the number of heating degree days compared to the prior period. In addition, the commodity price of natural gas declined by 26% per unit compared to the same period last year.

|                    | Three Months Ended<br>March 31, |              | Increase<br>(Decrease) | Percentage |   |
|--------------------|---------------------------------|--------------|------------------------|------------|---|
|                    | 2015                            | 2014         |                        |            |   |
| Gross Margin       |                                 |              |                        |            |   |
| Gas Utilities      | \$10,052,489                    | \$10,039,357 | \$13,132               | —          | % |
| Other              | 161,281                         | 121,768      | 39,513                 | 32         | % |
| Total Gross Margin | \$10,213,770                    | \$10,161,125 | \$52,645               | 1          | % |

Regulated natural gas margins from utility operations were nearly unchanged from the same period last year primarily as a result of higher SAVE Plan revenues offsetting lower volumetric margins. As discussed above, both the current quarter and the same quarter last year were colder than normal. Under the provisions of the WNA, the Company must refund the excess margin earned on sales related to colder than normal weather. However, in the prior year, the WNA mechanism provided for a weather band of 3% variance from normal. As a result, the Company was able to retain the additional margin generated for the first 3% of weather that was colder than normal and provide for a refund for the excess margin above the 3% band in the prior year. Essentially, the 3% weather band from last year provided approximately \$240,000 in additional margin recognized. SAVE Plan revenues increased by approximately \$202,000 related to the infrastructure upgrades to the Company's distribution pipelines and liquified natural gas ("LNG") plant in the absence of a non-gas rate increase. Customer base charges, a flat monthly fee billed to each natural gas customer, also increased due to customer growth.

The components of and the change in gas utility margin are summarized below:

## RGC RESOURCES, INC. AND SUBSIDIARIES

|                      | Three Months Ended<br>March 31, |              | Increase<br>(Decrease) |
|----------------------|---------------------------------|--------------|------------------------|
|                      | 2015                            | 2014         |                        |
| Customer Base Charge | \$3,094,631                     | \$3,070,347  | \$24,284               |
| Carrying Cost        | 165,490                         | 138,468      | 27,022                 |
| SAVE Plan            | 310,242                         | 108,083      | 202,159                |
| Volumetric           | 7,190,258                       | 7,414,514    | (224,256 )             |
| WNA                  | (734,313 )                      | (718,700 )   | (15,613 )              |
| Other Gas Revenues   | 26,181                          | 26,645       | (464 )                 |
| Total                | \$10,052,489                    | \$10,039,357 | \$13,132               |

Other margins increased by \$39,513 from the same period last year primarily due increased activity under the Company's non-gas contracts. Much of the other revenues and margins are subject to variations in the level of activity and generally are associated with service contracts that have a limited duration or are subject to renewal on an annual or semi-annual basis. Any continuation of these contracts beyond their current expiration dates is uncertain.

Operation and maintenance expenses increased by \$199,487, or 6%, primarily due to higher benefit costs and lower capitalization of overheads. Total benefit costs increased by \$41,000 primarily related to increased pension and postretirement medical costs due to the amortization of higher actuarial losses. In addition, capitalized overheads declined by approximately \$151,000 resulting from lower capital expenditures during the quarter attributable to winter weather and project mix. The remaining differences were related to various minor fluctuations in other expenses.

General taxes increased by \$11,881, or 3%, primarily due to higher property taxes associated with increases in utility property.

Depreciation expense increased by \$82,830, or 7%, on a 9% increase in utility plant investment. The Company implemented lower depreciation rates in the fourth quarter of fiscal 2014, which slightly reduced the Company's average composite depreciation rates.

Other expense, net, decreased by \$38,822 primarily due to timing of charitable contributions and reduced SCC pipeline assessments.

Interest expense declined by \$70,495, or 15%, due to the refinancing of the Company's debt in September 2014 at a lower average interest rate, which more than offset increased line-of-credit utilization.

Income tax expense decreased by \$64,785, which corresponds to the decrease in pre-tax income for the quarter. The effective tax rate was 38% for the three months ended March 31, 2015 and 2014, respectively.

#### Six Months Ended March 31, 2015:

Net income increased by \$134,137 for the six-months ended March 31, 2015, compared to the same period last year.

SAVE Plan revenues and higher customer base charge revenue more than offset higher operating expenses.

The tables below reflect operating revenues, volume activity and heating degree-days.



## RGC RESOURCES, INC. AND SUBSIDIARIES

|                                  | Six Months Ended<br>March 31, |              | Increase<br>(Decrease) | Percentage |    |
|----------------------------------|-------------------------------|--------------|------------------------|------------|----|
|                                  | 2015                          | 2014         |                        |            |    |
| Operating Revenues               |                               |              |                        |            |    |
| Gas Utilities                    | \$47,067,428                  | \$52,230,894 | \$(5,163,466 )         | (10        | )% |
| Other                            | 614,366                       | 480,265      | 134,101                | 28         | %  |
| Total Operating Revenues         | \$47,681,794                  | \$52,711,159 | \$(5,029,365 )         | (10        | )% |
| Delivered Volumes                |                               |              |                        |            |    |
| Regulated Natural Gas (DTH)      |                               |              |                        |            |    |
| Residential and Commercial       | 5,668,549                     | 5,668,873    | (324 )                 | —          | %  |
| Transportation and Interruptible | 1,607,969                     | 1,688,022    | (80,053 )              | (5         | )% |
| Total Delivered Volumes          | 7,276,518                     | 7,356,895    | (80,377 )              | (1         | )% |
| Heating Degree Days (Unofficial) | 3,954                         | 4,018        | (64 )                  | (2         | )% |

Total operating revenues for the six months ended March 31, 2015, compared to the same period last year, decreased primarily due to a combination of lower natural gas costs partially offset by higher SAVE Plan revenues and customer base charge revenue. The commodity price of natural gas declined by 16% per unit compared to the same period last year. Other revenues increased by 28% due to increased activity under the Company's non-gas contracts.

|                    | Six Months Ended<br>March 31, |              | Increase  | Percentage |   |
|--------------------|-------------------------------|--------------|-----------|------------|---|
|                    | 2015                          | 2014         |           |            |   |
| Gross Margin       |                               |              |           |            |   |
| Gas Utilities      | \$18,536,173                  | \$18,128,350 | \$407,823 | 2          | % |
| Other              | 299,740                       | 235,767      | 63,973    | 27         | % |
| Total Gross Margin | \$18,835,913                  | \$18,364,117 | \$471,796 | 3          | % |

Regulated natural gas margins from utility operations increased from the same period last year primarily as a result of higher SAVE Plan revenues and customer base charge revenue more than offsetting lower volumetric margins. SAVE Plan revenues increased approximately \$421,000 as the Company entered its second year under the current SAVE Plan. When the Company files a non-gas rate increase, the SAVE Plan revenues are incorporated into the rate structure of the new non-gas rates. The last non-gas rate increase was implemented effective November 1, 2013. As the Company continues to invest in eligible SAVE Plan infrastructure, the associated SAVE Plan revenues will continue to increase. Customer base charges also increased due to customer growth. As discussed above, the prior year WNA mechanism provided for a weather band of 3% variance from normal whereby the Company could retain the excess margin earned on sales related to weather up to 3% colder than normal and refund the additional margin earned for weather in excess of 3% colder than normal. The effect of 3% weather band resulted in approximately \$240,000 in additional margin last year that would not have been realized if the current 0% weather band had been in place. The components of and the change in gas utility margin are summarized below:

## RGC RESOURCES, INC. AND SUBSIDIARIES

|                      | Six Months Ended |              | Increase<br>(Decrease) |
|----------------------|------------------|--------------|------------------------|
|                      | March 31,        |              |                        |
|                      | 2015             | 2014         |                        |
| Customer Base Charge | \$6,131,799      | \$5,994,539  | \$137,260              |
| Carrying Cost        | 479,791          | 433,228      | 46,563                 |
| SAVE Plan            | 548,502          | 127,315      | 421,187                |
| Volumetric           | 12,157,090       | 12,231,674   | (74,584)               |
| WNA                  | (843,352)        | (718,700)    | (124,652)              |
| Other Gas Revenues   | 62,343           | 60,294       | 2,049                  |
| Total                | \$18,536,173     | \$18,128,350 | \$407,823              |

Other margins increased by \$63,973 from the same period last year primarily due to increased activity under the Company's non-gas contracts.

Operation and maintenance expenses increased by \$280,789, or 4%, primarily due to higher labor and benefit costs. Total benefit costs increased by \$195,000 primarily related to increased pension and postretirement medical costs due to the amortization of higher actuarial losses. Total labor expense increased by \$115,000 due to small increase in employee count from the prior year. The remaining differences were related to various minor fluctuations in other expenses.

General taxes increased by \$29,194, or 4%, primarily due to higher property taxes associated with increases in utility property and higher payroll taxes.

Depreciation expense increased by \$161,660, or 7%, on a corresponding increase in utility plant investment.

Other expense, net, decreased by \$58,078 primarily due to timing of charitable contributions and reduced SCC pipeline assessments.

Interest expense decreased by \$137,881, or 15%, due to the refinancing of the Company's debt in September 2014 at a lower average interest rate.

Income tax expense increased by \$61,975, which corresponds to the increase in pre-tax income for the period. The effective tax rate was 38% for the both periods.

#### Critical Accounting Policies and Estimates

The consolidated financial statements of Resources are prepared in accordance with accounting principles generally accepted in the United States of America. The amounts of assets, liabilities, revenues and expenses reported in the Company's financial statements are affected by accounting policies, estimates and assumptions that are necessary to comply with generally accepted accounting principles. Estimates used in the financial statements are derived from prior experience, statistical analysis and professional judgments. Actual results may differ significantly from these estimates and assumptions.

The Company considers an estimate to be critical if it is material to the financial statements and it requires assumptions to be made that were uncertain at the time the estimate was made and changes in the estimate are reasonably likely to occur from period to period. There have been no changes to the critical accounting policies as reflected in the Company's Annual Report on Form 10-K for the year ended September 30, 2014.

#### Asset Management

Roanoke Gas uses a third party asset manager to manage its pipeline transportation and storage rights and gas supply inventories and deliveries. In return for being able to utilize the excess capacities of the transportation and storage rights, the third party pays Roanoke Gas a monthly utilization fee, which is used to reduce the cost of gas for customers. The current agreement expires in March 2017.

#### Regulatory

Over the last four years, the Company has filed annually for an increase in non-gas rates to provide recovery on increasing operating costs and investment in natural gas distribution facilities. With the implementation of the SAVE Plan Rider along with other factors, the Company was able to forgo the need to file a non-gas rate case in 2014. The SAVE Rider allows the Company to recover the related depreciation and expenses and return on rate base of the additional capital investment related to

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## RGC RESOURCES, INC. AND SUBSIDIARIES

the ongoing replacement of aging natural gas infrastructure assets without a formal rate case and hearing. The Company is in the process of filing its SAVE Plan for 2016. The current SAVE Plan Rider will remain in effect until the Company files its next non-gas rate increase. The new rates would then incorporate the investment in the infrastructure previously recovered through the SAVE Plan Rider. The Company has not yet determined if it will be filing for a non-gas rate increase later this year.

On June 25, 2014, the SCC issued an order granting approval of the Company's application to extend its authority to incur short-term indebtedness of up to \$30,000,000 and to issue up to \$60,000,000 in long-term debt securities. The short-term indebtedness authority allows the Company to access its line-of-credit to provide seasonal working capital funding and provide bridge financing for its capital expenditures. With this approval, the Company was also able to refinance \$28,000,000 of higher interest rate debt with \$30,500,000 of lower-rate debt in September 2014. The new debt has a stated interest rate of 4.26% and an effective rate of 4.67% compared to an average rate of 6.30% and effective rate of 6.43% on the retired debt. This authorization also provides the Company with the opportunity to move some of the bridge financing provided by the line-of-credit to more permanent long-term debt during the five-year authorization period.

The Company currently holds the only franchises and/or certificates of public convenience and necessity to distribute natural gas in its service area. Certificates of public convenience and necessity are issued by the SCC to provide service in the counties in the Company's service territory. These certificates are intended for perpetual duration subject to compliance and regulatory standards. Franchises are granted by the local cities and towns served by the Company. The current franchises with the City of Roanoke, the City of Salem and the Town of Vinton will expire January 1, 2016. The Company is currently in negotiations to extend or renew the franchises in each of these localities. Management anticipates that it will be able to renew or extend all of its franchises.

On March 25, 2015, the Company filed an application for approval of a Certificate of Public Convenience and Necessity with the SCC to include the remaining uncertificated portions of Franklin County into its authorized natural gas service territory.

#### Capital Resources and Liquidity

Due to the capital intensive nature of the utility business, as well as the related weather sensitivity, the Company's primary capital needs are the funding of its continuing construction program, the seasonal funding of its natural gas inventories, accounts receivable and payment of dividends. To meet these needs, the Company relies on its operating cash flows, line-of-credit agreement, long-term debt, and to a lesser extent, capital raised through the Company's stock plans.

Cash and cash equivalents increased by \$28,548 for the six-month period ended March 31, 2015 compared to a \$924,800 increase for the same period last year. The following table summarizes the sources and uses of cash:

|                                       | Six Months Ended<br>March 31, |              |
|---------------------------------------|-------------------------------|--------------|
|                                       | 2015                          | 2014         |
| Cash Flow Summary Six Months Ended:   |                               |              |
| Provided by operating activities      | \$14,898,163                  | \$9,694,189  |
| Used in investing activities          | (6,796,625 )                  | (7,195,308 ) |
| Used in financing activities          | (8,072,990 )                  | (1,574,081 ) |
| Increase in cash and cash equivalents | \$28,548                      | \$924,800    |

The seasonal nature of the natural gas business causes operating cash flows to fluctuate significantly during the year as well as from year to year. Factors including weather, energy prices, natural gas storage levels and customer collections contribute to working capital levels and the related cash flows. Generally, operating cash flows are positive during the second and third quarters as a combination of earnings, declining storage gas levels and collections on customer accounts all contribute to higher cash levels. During the first and fourth quarters, operating cash flows

generally decrease due to increases in natural gas storage levels, rising customer receivable balances and construction activity.

Cash flow provided by operations increased by \$5,203,974 from \$9,694,189 for the six months ended March 31, 2014 to \$14,898,163 for the six months ended March 31, 2015, primarily due to an increase in over-collection of gas costs. The amount of the over-collection for the current six-month period increased by nearly \$4,300,000 over the same period last year as the commodity price of gas declined during the current winter. The gas cost component of the Company's natural gas billing rates was derived based on pricing expectations in early December, which indicated prices would hold steady during the winter season. Instead, the commodity price of gas declined by nearly \$1.50 per decatherm from December 2014 until early February

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2015, at which time the price leveled off. Abundant supplies contributed to the decline in natural gas prices. The windfall of cash collected will be short-lived as the Company has adjusted the gas cost component of rates to take into account the lower prices. In addition, any remaining over-collection will be refunded to customers during the 2016 calendar year. The remainder of the increase primarily relates to lower income tax payments due to the extension of bonus depreciation to the end of 2014 and higher net income and depreciation.

Investing activities are generally composed of expenditures under the Company's construction program, which primarily involves replacing aging bare steel and cast iron pipe with new plastic or coated steel pipe, improvements to the LNG plant, and expanding its natural gas system to meet the demands of customer growth. Expenditures for infrastructure and equipment have continued at the higher levels experienced over the last few years as the Company continues its ongoing pipeline replacement program; however, cash flows used in investing activities actually decreased by \$398,683 for the six-months ended March 31, 2015 as the prior year included capital expenditures related to the replacement of the LNG boil off compressor and a custody transfer station. The Company currently expects to finish replacing the remaining bare steel and cast iron pipe within its natural gas distribution system in 2016 and then will shift efforts to replacing pre-1973 first generation plastic pipe with current polyethylene pipe. In addition, the Company is evaluating other capital improvement projects. As a result, capital expenditures are expected to remain at elevated levels over the next few years. Operating cash flows and corporate borrowing are expected to provide the funding for completing these projects.

Financing activities generally consist of long-term and short-term borrowings and repayments, issuance of stock and the payment of dividends. As discussed above, the Company uses its line-of-credit arrangement to fund seasonal working capital needs as well as provide temporary financing for capital projects. Cash flows used in financing activities increased by \$6,498,909 primarily due to the pay down on the balance of the Company's line-of-credit. Due to the ongoing level of capital projects, corporate borrowing will continue to increase. The Company will use the line-of-credit for bridge financing and will evaluate the need and timing to convert some of this debt to more permanent financing.

Effective March 31, 2015, the Company entered into a new line-of-credit agreement. The new agreement maintained the same terms and rates as provided for under the expired agreement. The interest rate is based on 30-day LIBOR plus 100 basis points and includes an availability fee of 15 basis points applied to the difference between the face amount of the note and the average outstanding balance during the period. The Company maintained multi-tiered borrowing limits to accommodate seasonal borrowing demand and minimize overall borrowing costs with available limits ranging from \$6,000,000 to \$24,000,000 during the term of the agreement. The limits are higher than the expiring agreement due to expected funding needs of the Company's capital budget. The line-of-credit will expire on March 31, 2016. The Company anticipates being able to extend or replace its current line-of-credit agreement upon expiration; however, there is no guarantee that the line-of-credit will be extended or replaced on terms comparable to those currently in place.

At March 31, 2015, the Company's consolidated long-term capitalization was 64% equity and 36% debt. The Company's total consolidated capitalization including the line-of-credit was 62% equity and 38% debt.

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ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risks associated with interest rates and commodity prices. Interest rate risk is related to the Company's outstanding short-term debt. Commodity price risk is experienced by the Company's regulated natural gas operations. The Company's risk management policy, as authorized by the Company's Board of Directors, allows management to enter into derivatives for the purpose of managing commodity and financial market risks of its business operations.

Interest Rate Risk

The Company is exposed to market risk related to changes in interest rates associated with its borrowing activities. At March 31, 2015, the Company had \$2,591,698 outstanding under its variable rate line-of-credit with an average balance outstanding during the period of \$10,991,153. A hypothetical 100 basis point increase in market interest rates applicable to the Company's variable rate line-of-credit outstanding during the period would have resulted in an increase in interest expense for the current period of approximately \$56,000. The Company's long-term debt is at fixed rates.

Commodity Price Risk

The Company manages the price risk associated with purchases of natural gas by using a combination of liquefied natural gas (LNG) storage, underground storage gas, fixed price contracts, spot market purchases and derivative commodity instruments including futures, price caps, swaps and collars.

At March 31, 2015, the Company had no outstanding derivative instruments to hedge the price of natural gas. The Company had 602,940 decatherms of gas in storage, including LNG, at an average price of \$4.75 per decatherm compared to 457,733 decatherms at an average price of \$4.36 per decatherm last year. The SCC currently allows for full recovery of prudent costs associated with natural gas purchases, as any additional costs or benefits associated with the settlement of derivative contracts and other price hedging techniques are passed through to customers when realized through the PGA mechanism.

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ITEM 4 – CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to be effective in providing reasonable assurance that information required to be disclosed in reports under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (the “SEC”), and that such information is accumulated and communicated to management to allow for timely decisions regarding required disclosure.

As of March 31, 2015, the Company completed an evaluation, under the supervision and with the participation of management, including the chief executive officer and the chief financial officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures. Based upon that evaluation, the chief executive officer and chief financial officer concluded that the Company’s disclosure controls and procedures were effective at the reasonable assurance level as of March 31, 2015.

Management routinely reviews the Company’s internal control over financial reporting and makes changes, as necessary, to enhance the effectiveness of the internal controls over financial reporting. There were no changes in the internal controls over financial reporting during the fiscal quarter ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.



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## Part II – Other Information

## ITEM 1 – LEGAL PROCEEDINGS

The Company was a defendant in two civil lawsuits associated with a November 2009 propane tank explosion and fire at a West Virginia residence. The first lawsuit was dismissed by order on March 31, 2015, and the second lawsuit was dismissed by order on April 27, 2015. The final resolution was consistent with management's expectations as the settlement did not materially affect the Company's financial position, results of operation, or liquidity. The Company is not known to be a party to any other pending legal proceedings.

## ITEM 1A – RISK FACTORS

No changes.

## ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

## ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4 – MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5 – OTHER INFORMATION

None.

## ITEM 6 – EXHIBITS

| Number | Description   |
|--------|---|
| 10.1   | Revolving Line of Credit Note in the original principal amount of \$24,000,000 by Roanoke Gas Company in favor of Wells Fargo Bank, N.A. dated March 31, 2015 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on April 3, 2015).  |
| 10.2   | Credit Agreement by and between Roanoke Gas Company and Wells Fargo Bank, N.A. dated March 31, 2015 (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on April 3, 2015).  |
| 10.3   | Continuing Guaranty by RGC Resources, Inc. in favor of Wells Fargo Bank, N.A. dated March 31, 2015 (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on April 3, 2015).   |
| 31.1   | Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer.  |
| 31.2   | Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer.  |
| 32.1*  | Section 1350 Certification of Principal Executive Officer.  |
| 32.2*  | Section 1350 Certification of Principal Financial Officer.  |
| 101    | The following materials from the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at March 31, 2015 and September 30, 2014, (ii) Condensed Consolidated Statements of Income for the three months and six months ended March 31, 2015 and 2014; (iii) Condensed Consolidated Statements of Comprehensive Income for the three months and six months ended March 31, 2015 and 2014; (iv) Condensed Consolidated Statements of Cash Flows for the six months ended March 31, 2015 and 2014, and (v) Condensed Notes to Condensed Consolidated Financial Statements. |

These certifications are being furnished solely to accompany this quarterly report pursuant to 18 U.S.C.

\* Section 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of the Registrant, whether made before or after the date hereof, regardless of any general incorporation language in such filing.



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SIGNATURES

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

RGC Resources, Inc.

Date: May 7, 2015

By: /s/ Paul W. Nester  
Paul W. Nester  
Vice President, Secretary, Treasurer and  
CFO