

RGC RESOURCES INC  
Form 10-Q  
May 10, 2013

**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, 2013

Commission File Number 000-26591

**RGC Resources, Inc.**

(Exact name of Registrant as Specified in its Charter)

**VIRGINIA**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**54-1909697**  
(I.R.S. Employer  
Identification No.)

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

24016  
(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, 2013 |
|-----------------------------|-------------------------------|
| Common Stock, \$5 Par Value | 4,705,876                     |

RGC RESOURCES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

|   | March 31,<br>2013     | September 30,<br>2012 |
|---|-----------------------|-----------------------|
| <b>ASSETS</b>   |                       |                       |
| <b>CURRENT ASSETS:</b>  |                       |                       |
| Cash and cash equivalents   | \$ 12,180,923         | \$ 8,909,871          |
| Accounts receivable (less allowance for uncollectibles of \$243,694 and \$65,219, respectively) | 12,348,768            | 3,617,925             |
| Notes receivable  | 95,385                | 1,142,770             |
| Materials and supplies  | 697,512               | 613,548               |
| Gas in storage  | 3,153,567             | 9,466,095             |
| Prepaid income taxes  |                       | 2,072,687             |
| Deferred income taxes   | 4,421,907             | 2,371,609             |
| Under-recovery of gas costs   |                       | 687,194               |
| Other   | 1,349,525             | 1,365,615             |
| <br>  |                       |                       |
| Total current assets  | 34,247,587            | 30,247,314            |
| <br>  |                       |                       |
| <b>UTILITY PROPERTY:</b>  |                       |                       |
| In service  | 139,658,085           | 135,912,571           |
| Accumulated depreciation and amortization   | (47,779,234)          | (46,563,520)          |
| <br>  |                       |                       |
| In service, net   | 91,878,851            | 89,349,051            |
| Construction work in progress   | 1,540,095             | 1,481,041             |
| <br>  |                       |                       |
| Utility plant, net  | 93,418,946            | 90,830,092            |
| <br>  |                       |                       |
| <b>OTHER ASSETS:</b>  |                       |                       |
| Regulatory assets   | 8,521,860             | 8,542,048             |
| Other   | 106,869               | 136,884               |
| <br>  |                       |                       |
| Total other assets  | 8,628,729             | 8,678,932             |
| <br>  |                       |                       |
| <b>TOTAL ASSETS</b>   | <b>\$ 136,295,262</b> | <b>\$ 129,756,338</b> |

See notes to condensed consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

|   | March 31,<br>2013  | September 30,<br>2012 |
|---|--------------------|-----------------------|
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                    |                       |
| <b>CURRENT LIABILITIES:</b>   |                    |                       |
| Note payable  | \$ 15,000,000      | \$ 15,000,000         |
| Dividends payable   | 847,058            | 817,462               |
| Accounts payable  | 7,757,622          | 4,756,460             |
| Customer credit balances  | 477,312            | 2,382,089             |
| Income taxes payable  | 1,978,161          |                       |
| Customer deposits   | 1,634,048          | 1,567,501             |
| Accrued expenses  | 2,359,121          | 2,102,165             |
| Over-recovery of gas costs  | 3,594,863          |                       |
| Fair value of marked-to-market transactions   | 2,514,469          | 2,916,718             |
| <br>Total current liabilities   | <br>36,162,654     | <br>29,542,395        |
| <br><b>LONG-TERM DEBT</b>   | <br>13,000,000     | <br>13,000,000        |
| <br><b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>  |                    |                       |
| Asset retirement obligations  | 4,308,562          | 4,251,295             |
| Regulatory cost of retirement obligations   | 8,123,568          | 7,828,157             |
| Benefit plan liabilities  | 12,385,723         | 12,541,251            |
| Deferred income taxes   | 12,746,170         | 11,898,178            |
| Deferred investment tax credits   | 7,614              | 12,132                |
| <br>Total deferred credits and other liabilities  | <br>37,571,637     | <br>36,531,013        |
| <br><b>STOCKHOLDERS EQUITY:</b>   |                    |                       |
| Common stock, \$5 par value; authorized 10,000,000 shares; issued and outstanding 4,705,455 and 4,670,567, respectively | 23,527,275         | 23,352,835            |
| Preferred stock, no par, authorized 5,000,000 shares; no shares issued and outstanding                                  |                    |                       |
| Capital in excess of par value  | 7,862,232          | 7,375,666             |
| Retained earnings   | 21,789,175         | 23,904,514            |
| Accumulated other comprehensive loss  | (3,617,711)        | (3,950,085)           |
| <br>Total stockholders equity   | <br>49,560,971     | <br>50,682,930        |
| <br><b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>  | <br>\$ 136,295,262 | <br>\$ 129,756,338    |

RGC RESOURCES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE-MONTH AND SIX-MONTH PERIODS ENDED MARCH 31, 2013 AND 2012

UNAUDITED

|  | Three Months Ended  |                     | Six Months Ended    |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | 2013                | March 31,<br>2012   | 2013                | March 31,<br>2012   |
| <b>OPERATING REVENUES:</b>               |                     |                     |                     |                     |
| Gas utilities                            | \$ 23,776,730       | \$ 21,021,336       | \$ 42,235,469       | \$ 39,194,781       |
| Other                                    | 398,908             | 268,891             | 686,761             | 594,622             |
| Total operating revenues                 | 24,175,638          | 21,290,227          | 42,922,230          | 39,789,403          |
| <b>COST OF SALES:</b>                    |                     |                     |                     |                     |
| Gas utilities                            | 14,345,478          | 12,037,287          | 24,995,939          | 22,250,062          |
| Other                                    | 244,433             | 134,418             | 404,081             | 291,192             |
| Total cost of sales                      | 14,589,911          | 12,171,705          | 25,400,020          | 22,541,254          |
| <b>GROSS MARGIN</b>                      | <b>9,585,727</b>    | <b>9,118,522</b>    | <b>17,522,210</b>   | <b>17,248,149</b>   |
| <b>OTHER OPERATING EXPENSES:</b>         |                     |                     |                     |                     |
| Operations and maintenance               | 3,253,269           | 3,236,558           | 6,758,112           | 6,561,720           |
| General taxes                            | 398,638             | 363,310             | 759,715             | 703,732             |
| Depreciation and amortization            | 1,120,472           | 1,063,483           | 2,240,944           | 2,118,581           |
| Total other operating expenses           | 4,772,379           | 4,663,351           | 9,758,771           | 9,384,033           |
| <b>OPERATING INCOME</b>                  | <b>4,813,348</b>    | <b>4,455,171</b>    | <b>7,763,439</b>    | <b>7,864,116</b>    |
| OTHER INCOME (EXPENSE), Net              | (575)               | 6,260               | 16,467              | 16,159              |
| <b>INTEREST EXPENSE</b>                  | <b>454,853</b>      | <b>456,710</b>      | <b>914,314</b>      | <b>915,709</b>      |
| <b>INCOME BEFORE INCOME TAXES</b>        | <b>4,357,920</b>    | <b>4,004,721</b>    | <b>6,865,592</b>    | <b>6,964,566</b>    |
| <b>INCOME TAX EXPENSE</b>                | <b>1,659,213</b>    | <b>1,521,414</b>    | <b>2,612,732</b>    | <b>2,646,347</b>    |
| <b>NET INCOME</b>                        | <b>\$ 2,698,707</b> | <b>\$ 2,483,307</b> | <b>\$ 4,252,860</b> | <b>\$ 4,318,219</b> |
| <b>BASIC EARNINGS PER COMMON SHARE</b>   | <b>\$ 0.57</b>      | <b>\$ 0.54</b>      | <b>\$ 0.91</b>      | <b>\$ 0.93</b>      |
| <b>DILUTED EARNINGS PER COMMON SHARE</b> | <b>\$ 0.57</b>      | <b>\$ 0.53</b>      | <b>\$ 0.91</b>      | <b>\$ 0.93</b>      |

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|                                     |    |       |    |       |    |       |    |       |
|-------------------------------------|----|-------|----|-------|----|-------|----|-------|
| DIVIDENDS DECLARED PER COMMON SHARE | \$ | 0.180 | \$ | 0.175 | \$ | 1.360 | \$ | 0.350 |
|-------------------------------------|----|-------|----|-------|----|-------|----|-------|

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, 2013 AND 2012

UNAUDITED

|   | Three Months Ended |                   | Six Months Ended  |                   |
|---|--------------------|-------------------|-------------------|-------------------|
|   | March 31,<br>2013  | March 31,<br>2012 | March 31,<br>2013 | March 31,<br>2012 |
| NET INCOME                              | \$ 2,698,707       | \$ 2,483,307      | \$ 4,252,860      | \$ 4,318,219      |
| Other comprehensive income, net of tax: |                    |                   |                   |                   |
| Interest rate SWAPs                     | 103,348            | 88,704            | 249,554           | 177,271           |
| Defined benefit plans                   | 41,410             | 38,345            | 82,820            | 76,690            |
| OTHER COMPREHENSIVE INCOME, NET OF TAX  | 144,758            | 127,049           | 332,374           | 253,961           |
| COMPREHENSIVE INCOME                    | \$ 2,843,465       | \$ 2,610,356      | \$ 4,585,234      | \$ 4,572,180      |

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, 2013 AND 2012

UNAUDITED

|   | Six Months Ended     |                      |
|---|----------------------|----------------------|
|   | 2013                 | 2012                 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                      |                      |
| Net income  | \$ 4,252,860         | \$ 4,318,219         |
| Adjustments to reconcile net income to net cash provided by operating activities:                                 |                      |                      |
| Depreciation and amortization   | 2,328,636            | 2,198,955            |
| Cost of removal of utility plant, net   | (220,341)            | (189,347)            |
| Changes in assets and liabilities which used cash, exclusive of changes and noncash transactions shown separately | 5,978,680            | 6,887,679            |
| <b>Net cash provided by operating activities</b>  | <b>12,339,835</b>    | <b>13,215,506</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                      |                      |
| Additions to utility plant and nonutility property  | (4,441,536)          | (4,024,345)          |
| Proceeds from disposal of equipment   | 2,966                | 2,750                |
| <b>Net cash used in investing activities</b>  | <b>(4,438,570)</b>   | <b>(4,021,595)</b>   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                      |                      |
| Proceeds on collection of notes   | 1,047,385            | 182,385              |
| Borrowings under line-of-credit agreement   | 4,354,402            |                      |
| Repayments under line-of-credit agreement   | (4,354,402)          |                      |
| Proceeds from issuance of stock (34,888 and 17,637 shares, respectively)  | 661,006              | 322,225              |
| Cash dividends paid   | (6,338,604)          | (1,597,129)          |
| <b>Net cash used in financing activities</b>  | <b>(4,630,213)</b>   | <b>(1,092,519)</b>   |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>  | <b>3,271,052</b>     | <b>8,101,392</b>     |
| <b>BEGINNING CASH AND CASH EQUIVALENTS</b>  | <b>8,909,871</b>     | <b>7,951,429</b>     |
| <b>ENDING CASH AND CASH EQUIVALENTS</b>   | <b>\$ 12,180,923</b> | <b>\$ 16,052,821</b> |
| <b><u>SUPPLEMENTAL CASH FLOW INFORMATION:</u></b>   |                      |                      |
| Interest paid   | \$ 892,765           | \$ 883,283           |
| Income taxes paid (refunded) net  | (27,924)             | 150,225              |
| <b>SUPPLEMENTAL INFORMATION - NON-CASH TRANSACTION:</b>   |                      |                      |



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The Company's \$15,000,000 note due March 31, 2013 was refinanced with the issuance of a \$15,000,000 one-year term note dated March 31, 2013.

See notes to condensed consolidated financial statements.

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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 RGC Resources, Inc.'s financial position as of March 31, 2013 and the results of its operations and comprehensive income for the three months and six months ended March 31, 2013 and 2012 and its cash flows for the six months ended March 31, 2013 and 2012. The results of operations for the three months and six months ended March 31, 2013 are not indicative of the results to be expected for the fiscal year ending September 30, 2013 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. The September 30, 2012 balance sheet was included in the Company's audited financial statements on 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, 2012. Newly adopted and newly issued accounting standards are discussed below.

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RGC RESOURCES, INC. AND SUBSIDIARIES

***Recently Issued Accounting Standards***

In June 2011, the FASB issued guidance under FASB ASC No. 220 *Comprehensive Income* that defines the presentation of Comprehensive Income in the financial statements. According to the guidance, an entity may present a single continuous statement of comprehensive income or two separate statements – a statement of income and a statement of other comprehensive income that immediately follows the statement of income. In either presentation, the entity is required to present on the face of the financial statement the components of other comprehensive income including the reclassification adjustment for items that are reclassified from other comprehensive income to net income. In December 2011, the FASB issued additional guidance under FASB ASC No. 220 that deferred the effective date of earlier guidance with regard to the presentation of reclassifications of items out of accumulated other comprehensive income. All other provisions of the original guidance remain in effect. The new requirements have been included in the Consolidated Statements of Comprehensive Income presented in the Company's financial statements.

In February 2013, the FASB issued additional guidance regarding the reporting of amounts reclassified out of accumulated other comprehensive income. Under the new provisions, an entity must present the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income. The disclosures required under this guidance are provided in Note 6 below.

Other accounting standards that have been issued by the FASB or other standard-setting bodies 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 and 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 November 1, 2012, Roanoke Gas Company placed into effect new base rates, subject to refund, that provide for approximately \$1,840,000 in additional annual non-gas revenues. On March 21, 2013, the Company reached a stipulated agreement with the SCC staff for a non-gas rate award in the amount of \$649,639. On April 1, 2013, the Hearing Examiner issued his report accepting the stipulated agreement between the Company and SCC staff providing for a \$649,639 increase in non-gas revenues while maintaining a 9.75% authorized return on equity. On April 16, 2013, the SCC issued its final order approving the increase in annual non-gas revenues agreed to in the stipulation. The Company has recorded a provision for rate refund, including interest associated with customer billings, for the difference between the rates placed into effect on November 1 and the amount approved in the final order. Refunds to customers are scheduled to be completed during the May billing cycle.

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RGC RESOURCES, INC. AND SUBSIDIARIES

Roanoke Gas Company has in place a weather normalization adjustment mechanism ( WNA ) based on a weather measurement band around the most recent 30-year temperature average. The WNA provides for a weather band of 3% above or below the 30-year temperature average whereby the Company would recover from its customers the lost margin (excluding gas costs) from the impact of weather that is more than 3% warmer than the 30-year average or refund customers the excess earned from weather that is more than 3% colder than the 30-year average. As of March 31, 2013, total heating degree days for the current WNA period of April 2012 through March 2013 fell within the 3% weather band, thereby not triggering the WNA for the current year. The Company reversed the approximately \$182,000 in additional revenue accrued in the previous quarter. The Company recorded approximately \$1,163,000 and \$1,740,000 in WNA revenues for the quarter and six month WNA periods ended March 31, 2012, as total heating degree days were approximately 22% less than the 30-year average. The Company applied the provisions of FASB ASC No. 980, *Regulated Operations*, in recording the asset and revenue for the WNA.

### **3. Short-Term Debt**

The Company and Wells Fargo Bank entered into a new line-of-credit agreement dated March 31, 2013. The new agreement maintained the same variable interest rate of 30 day LIBOR plus 100 basis points and the availability fee of the prior line-of-credit agreement. The Company continued the multi-tiered borrowing limits to accommodate seasonal borrowing demands and to minimize borrowing costs. The Company's total available borrowing limits during the term of the line-of-credit agreement range from \$1,000,000 to \$7,000,000.

The line-of-credit agreement will expire March 31, 2014, unless extended. The Company anticipates being able to extend or replace the credit line upon expiration. At March 31, 2013, the Company had no outstanding balance under its line-of-credit agreement.

The Company also executed an unsecured promissory note dated March 31, 2013 in the amount of \$15,000,000. This note essentially extends the maturity date of the prior note to March 31, 2014 and retains all other terms and conditions provided for in the original promissory note. The Company anticipates being able to renew this note on comparable terms as currently in place until such time the note co-terminates with the corresponding interest rate swap.

### **4. Financing Receivables**

Financing receivables represent a contractual right to receive money either on demand or on fixed or determinable dates and are recognized as assets on the entity's balance sheet. The Company has two primary types of financing receivables: trade accounts receivable, resulting from the sale of natural gas and other services to its customers, and notes receivable. Trade accounts receivable are short-term in nature and a provision for uncollectible balances is

RGC RESOURCES, INC. AND SUBSIDIARIES

included in the financial statements. The Company's notes receivable represents the balance on a 24 month note from a customer related to the payment for relocating a portion of a natural gas distribution main. Management evaluates the status of the note each reporting period to make an assessment on the collectability of the outstanding balance. In its most recent evaluation, management concluded that the balance of the note continued to be fully collectible and no loss reserve was required. The note would be considered past due if either the interest or principal installment were outstanding for more than 30 days after its contractual due date. The Company also had a note receivable related to the sale of its Bluefield, Virginia natural gas distribution assets in October 2007. The \$865,000 balance on this note, which was due on November 1, 2013, was paid in full on February 1, 2013.

### 5. 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 has two interest rate swaps associated with its variable rate notes. The first swap relates to the \$15,000,000 term note originally issued in November 2005 and most recently renewed as a one year term loan due March 31, 2014 as described in Note 3. This swap essentially converts the floating rate note based upon LIBOR into fixed rate debt with a 5.74% effective interest rate. The second swap relates to the \$5,000,000 variable rate note issued in October 2008. This swap converts the variable rate note based on LIBOR into a fixed rate debt with a 5.79% effective interest rate. Both swaps qualify as cash flow hedges with changes in fair value reported in other comprehensive income. No portion of either interest rate swap was deemed ineffective during the periods presented.

The table below reflects the fair values of the derivative instruments and their corresponding classification in the condensed consolidated balance sheets under the current liabilities caption of Fair value of marked-to-market transactions as of March 31, 2013 and September 30, 2012:

|  | March 31,<br>2013 | September 30,<br>2012 |
|--|-------------------|-----------------------|
| Derivatives designated as hedging instruments: |                   |                       |
| Interest rate swaps                            | \$ 2,514,469      | \$ 2,916,718          |

RGC RESOURCES, INC. AND SUBSIDIARIES

The table in Note 6 reflects the effect on income and other comprehensive income of the Company's cash flow hedges.

Based on the current interest rate environment, management estimates that approximately \$930,000 of the fair value on the interest rate hedges will be reclassified from other comprehensive loss into interest expense on the income statement over the next 12 months. Changes in LIBOR rates during this period could significantly change the amount estimated to be reclassified to income as well as the fair value of the interest rate hedges.

RGC RESOURCES, INC. AND SUBSIDIARIES**6. Comprehensive Income**

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

|   | Before-Tax<br>Amount | Tax<br>(Expense)<br>or Benefit | Net-of-Tax<br>Amount |
|---|----------------------|--------------------------------|----------------------|
| <b>Three Months Ended March 31, 2013:</b>           |                      |                                |                      |
| Interest rate swaps:                                |                      |                                |                      |
| Unrealized losses                                   | \$ (67,899)          | \$ 25,774                      | \$ (42,125)          |
| Transfer of realized losses to interest expense     | 234,483              | (89,010)                       | 145,473              |
| <b>Net unrealized losses on interest rate SWAPs</b> | <b>166,584</b>       | <b>(63,236)</b>                | <b>103,348</b>       |
| Defined benefit plans:                              |                      |                                |                      |
| Amortization of actuarial losses                    | 54,973               | (20,868)                       | 34,105               |
| Amortization of transition obligation               | 11,774               | (4,469)                        | 7,305                |
| <b>Net defined benefit plans</b>                    | <b>66,747</b>        | <b>(25,337)</b>                | <b>41,410</b>        |
| Other comprehensive income                          | \$ 233,331           | \$ (88,573)                    | \$ 144,758           |
| <b>Three Months Ended March 31, 2012:</b>           |                      |                                |                      |
| Interest rate swaps:                                |                      |                                |                      |
| Unrealized losses                                   | \$ (89,195)          | \$ 33,859                      | \$ (55,336)          |
| Transfer of realized losses to interest expense     | 232,173              | (88,133)                       | 144,040              |
| <b>Net unrealized losses on interest rate SWAPs</b> | <b>142,978</b>       | <b>(54,274)</b>                | <b>88,704</b>        |
| Defined benefit plans:                              |                      |                                |                      |
| Amortization of actuarial losses                    | 50,034               | (18,993)                       | 31,041               |
| Amortization of transition obligation               | 11,773               | (4,469)                        | 7,304                |
| <b>Net defined benefit plans</b>                    | <b>61,807</b>        | <b>(23,462)</b>                | <b>38,345</b>        |
| Other comprehensive income                          | \$ 204,785           | \$ (77,736)                    | \$ 127,049           |

RGC RESOURCES, INC. AND SUBSIDIARIES

|   | Before-Tax<br>Amount | Tax<br>(Expense)<br>or Benefit | Net-of-Tax<br>Amount |
|---|----------------------|--------------------------------|----------------------|
| <b>Six Months Ended March 31, 2013:</b>             |                      |                                |                      |
| Interest rate swaps:                                |                      |                                |                      |
| Unrealized losses                                   | \$ (70,517)          | \$ 26,768                      | \$ (43,749)          |
| Transfer of realized losses to interest expense     | 472,765              | (179,462)                      | 293,303              |
| <b>Net unrealized losses on interest rate SWAPs</b> | <b>402,248</b>       | <b>(152,694)</b>               | <b>249,554</b>       |
| Defined benefit plans:                              |                      |                                |                      |
| Amortization of actuarial losses                    | 109,946              | (41,736)                       | 68,210               |
| Amortization of transition obligation               | 23,548               | (8,938)                        | 14,610               |
| <b>Net defined benefit plans</b>                    | <b>133,494</b>       | <b>(50,674)</b>                | <b>82,820</b>        |
| Other comprehensive income                          | \$ 535,742           | \$ (203,368)                   | \$ 332,374           |
| <b>Six Months Ended March 31, 2012:</b>             |                      |                                |                      |
| Interest rate swaps:                                |                      |                                |                      |
| Unrealized losses                                   | \$ (183,453)         | \$ 69,639                      | \$ (113,814)         |
| Transfer of realized losses to interest expense     | 469,190              | (178,105)                      | 291,085              |
| <b>Net unrealized losses on interest rate SWAPs</b> | <b>285,737</b>       | <b>(108,466)</b>               | <b>177,271</b>       |
| Defined benefit plans:                              |                      |                                |                      |
| Amortization of actuarial losses                    | 100,068              | (37,986)                       | 62,082               |
| Amortization of transition obligation               | 23,546               | (8,938)                        | 14,608               |
| <b>Net defined benefit plans</b>                    | <b>123,614</b>       | <b>(46,924)</b>                | <b>76,690</b>        |
| Other comprehensive income                          | \$ 409,351           | \$ (155,390)                   | \$ 253,961           |

The amortization of actuarial losses and transition obligation is included as a component of net periodic pension and postretirement benefit cost and is included in operations and maintenance expense.



RGC RESOURCES, INC. AND SUBSIDIARIES**Composition of Other Comprehensive Income**

|                            | Interest Rate<br>SWAPS | Defined Benefit<br>Plans | Accumulated<br>Other<br>Comprehensive<br>Income |
|----------------------------|------------------------|--------------------------|---|
| Balance September 30, 2012 | \$ (1,809,531)         | \$ (2,140,554)           | \$ (3,950,085)                                  |
| Other comprehensive income | 249,554                | 82,820                   | 332,374   |
| Balance March 31, 2013     | \$ (1,559,977)         | \$ (2,057,734)           | \$ (3,617,711)                                  |

**7. Earnings Per Share**

Basic earnings per common share for the three and six months ended March 31, 2013 and 2012 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 dilutive potential common shares. A reconciliation of basic and diluted earnings per share is presented below:

|                                     | Three Months Ended |                   | Six Months Ended  |                   |
|-------------------------------------|--------------------|-------------------|-------------------|-------------------|
|                                     | March 31,<br>2013  | March 31,<br>2012 | March 31,<br>2013 | March 31,<br>2012 |
| Net Income                          | \$ 2,698,707       | \$ 2,483,307      | \$ 4,252,860      | \$ 4,318,219      |
| Weighted average common shares      | 4,701,866          | 4,638,889         | 4,689,722         | 4,634,504         |
| Effect of dilutive securities:      |                    |                   |                   |                   |
| Options to purchase common stock    |                    | 5,362             |                   | 5,425             |
| Diluted average common shares       | 4,701,866          | 4,644,251         | 4,689,722         | 4,639,929         |
| Earnings Per Share of Common Stock: |                    |                   |                   |                   |
| Basic                               | \$ 0.57            | \$ 0.54           | \$ 0.91           | \$ 0.93           |
| Diluted                             | \$ 0.57            | \$ 0.53           | \$ 0.91           | \$ 0.93           |

**8. 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.

RGC RESOURCES, INC. AND SUBSIDIARIES

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 100% 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.

**9. 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 healthcare 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 |                   | Six Months Ended |                   |
|---|--------------------|-------------------|------------------|-------------------|
|   | 2013               | March 31,<br>2012 | 2013             | March 31,<br>2012 |
| <b>Components of net periodic pension cost:</b> |                    |                   |                  |                   |
| Service cost                                    | \$ 158,723         | \$ 130,425        | \$ 317,446       | \$ 260,850        |
| Interest cost                                   | 236,562            | 238,299           | 473,124          | 476,598           |
| Expected return on plan assets                  | (296,197)          | (239,795)         | (592,394)        | (479,590)         |
| Recognized loss                                 | 144,566            | 118,854           | 289,132          | 237,708           |
| Net periodic pension cost                       | \$ 243,654         | \$ 247,783        | \$ 487,308       | \$ 495,566        |

RGC RESOURCES, INC. AND SUBSIDIARIES

|   | Three Months Ended |                   | Six Months Ended  |                   |
|---|--------------------|-------------------|-------------------|-------------------|
|   | March 31,          |                   | March 31,         |                   |
|   | 2013               | 2012              | 2013              | 2012              |
| <b>Components of postretirement benefit cost:</b> |                    |                   |                   |                   |
| Service cost                                      | \$ 53,283          | \$ 48,944         | \$ 106,566        | \$ 97,888         |
| Interest cost                                     | 132,961            | 148,090           | 265,922           | 296,180           |
| Expected return on plan assets                    | (113,096)          | (91,840)          | (226,192)         | (183,680)         |
| Amortization of transition obligation             | 47,224             | 47,223            | 94,448            | 94,446            |
| Recognized loss                                   | 60,437             | 59,847            | 120,874           | 119,694           |
| <b>Net postretirement benefit cost</b>            | <b>\$ 180,809</b>  | <b>\$ 212,264</b> | <b>\$ 361,618</b> | <b>\$ 424,528</b> |

The Company contributed \$500,000 to its pension plan during the six-month period ended March 31, 2013. The Company currently expects to make additional contributions of approximately \$600,000 to its pension plan and \$850,000 to its postretirement benefit plan prior to the end of its fiscal year.

**10. 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).

RGC RESOURCES, INC. AND SUBSIDIARIES

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, 2013 and September 30, 2012:

|                       | Fair Value   | Fair Value Measurements - March 31, 2013  |   |   |
|-----------------------|--------------|---|---|---|
|                       |              | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Liabilities:</b>   |              |   |   |   |
| Natural gas purchases | \$ 2,146,022 | \$  | \$ 2,146,022                                  | \$  |
| Interest rate swaps   | 2,514,469    |   | 2,514,469                                     |   |
| Total                 | \$ 4,660,491 | \$  | \$ 4,660,491                                  | \$  |

|                       | Fair Value   | Fair Value Measurements - September 30, 2012 |   |   |
|-----------------------|--------------|--|---|---|
|                       |              | Quoted Prices in Active Markets (Level 1)    | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Liabilities:</b>   |              |  |   |   |
| Natural gas purchases | \$ 1,065,243 | \$   | \$ 1,065,243                                  | \$  |
| Interest rate swaps   | 2,916,718    |  | 2,916,718                                     |   |
| Total                 | \$ 3,981,961 | \$   | \$ 3,981,961                                  | \$  |

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, 2013 and September 30, 2012, 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 fair value of the interest rate swaps, included in the line item "Fair value of marked-to-market transactions", is determined by using the counterparty's proprietary models and certain assumptions regarding past, present and future market conditions.

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 to settle the obligation.

RGC RESOURCES, INC. AND SUBSIDIARIES

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 the Company's financial assets and liabilities that are not adjusted to fair value in the financial statements as of March 31, 2013 and September 30, 2012.

|                     | Carrying Value       | Fair Value Measurements - March 31, 2013  |   |   |
|---------------------|----------------------|---|---|---|
|                     |                      | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets:</b>      |                      |   |   |   |
| Notes receivable    | \$ 95,385            | \$  | \$  | \$ 94,799                                 |
| <b>Total</b>        | <b>\$ 95,385</b>     | <b>\$</b>                                 | <b>\$</b>                                     | <b>\$ 94,799</b>                          |
| <b>Liabilities:</b> |                      |   |   |   |
| Note payable        | \$ 15,000,000        | \$  | \$  | \$ 14,953,751                             |
| Long-term debt      | 13,000,000           |   |   | 14,135,595                                |
| <b>Total</b>        | <b>\$ 28,000,000</b> | <b>\$</b>                                 | <b>\$</b>                                     | <b>\$ 29,089,346</b>                      |

|                     | Carrying Value       | Fair Value Measurements - September 30, 2012 |   |   |
|---------------------|----------------------|--|---|---|
|                     |                      | Quoted Prices in Active Markets (Level 1)    | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets:</b>      |                      |  |   |   |
| Notes receivable    | \$ 1,142,770         | \$   | \$  | \$ 1,152,896                              |
| <b>Total</b>        | <b>\$ 1,142,770</b>  | <b>\$</b>                                    | <b>\$</b>                                     | <b>\$ 1,152,896</b>                       |
| <b>Liabilities:</b> |                      |  |   |   |
| Note payable        | \$ 15,000,000        | \$   | \$  | \$ 14,976,818                             |
| Long-term debt      | 13,000,000           |  |   | 14,310,450                                |
| <b>Total</b>        | <b>\$ 28,000,000</b> | <b>\$</b>                                    | <b>\$</b>                                     | <b>\$ 29,287,268</b>                      |

RGC RESOURCES, INC. AND SUBSIDIARIES

The fair value of the notes receivable are estimated by discounting future cash flows based on a range of rates for similar investments adjusted for management's expectation of credit and other risks. The fair value of the note payable is estimated by using the interest rate under the Company's line-of-credit agreement which renewed at the same time as the term note. Both the line-of-credit and term note have a term of one year. The fair value of long-term debt is estimated by discounting the future cash flows of the fixed rate debt at rates extrapolated based on current market conditions. The variable rate long-term debt has interest rate swaps that effectively convert such debt to a fixed rate. The values of the swap agreements are included in the first table above.

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, 2013 and September 30, 2012, 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.

**11. Subsequent Events**

Effective April 1, 2013, the Board of Directors granted 21,000 options to certain officers of the Company. In accordance with the Key Employee Stock Option Plan, the grant price was the closing price of the Company's stock on April 1, 2013. These options vest six months from the grant date and expire in 10 years.

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.

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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 of the Company's 2012 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, project, forecast, budget, assume, indicate or similar words or future or conditional verbs such as will, would, should, can, could or may 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, 2013. The total revenues and margins realized during the first six months reflect higher billings due to the weather sensitive nature of the gas business. Improvement or decline in earnings for the balance of the fiscal year will depend primarily on weather conditions during the remaining spring months, improvement or deterioration in the local economic environment and the level of operating and maintenance costs during the remainder of the year.

**Overview**

Resources is an energy services company primarily engaged in the regulated sale and distribution of natural gas to approximately 59,200 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).

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RGC RESOURCES, INC. AND SUBSIDIARIES

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 Company has in place certain approved rate mechanisms that reduce some of the volatility in earnings associated with variations in winter weather and the cost of natural gas.

Roanoke Gas has in place a weather normalization adjustment mechanism ( WNA ) based on a weather measurement band around 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 significantly warmer than normal and provides its customers with price protection when the weather is significantly colder than normal. The WNA mechanism provides for a weather band of 3% above and below the 30-year normal, whereby the Company would bill its customers for the lost margin (excluding gas costs) for the impact of weather that was more than 3% warmer than normal or refund customers the excess margin earned for weather that was more than 3% colder than normal. The annual WNA period extends from April to March. The Company had recorded approximately \$182,000 in WNA revenues for the quarter ended December 31, 2012 as the weather for the nine-month WNA period ended December 31, 2012 was approximately 8% warmer than normal. Colder than normal weather during the quarter ended March 31, 2013 reduced the heating-degree deficit to within the 3% weather band; consequently, the WNA revenues accrued during the prior quarter were reversed. Weather during the same quarter last year and the prior 12 month WNA period was significantly warmer than normal, and the Company recorded approximately \$1,163,000 and \$1,740,000 in additional revenues in the corresponding three-month and six-month periods last year to reflect the impact of the WNA for weather that was 22% above the 30-year average. Although the WNA mechanism provides the Company with a method to recover margin not realized for warmer weather above the 3% weather band, the statistical models used in determining the WNA amount do not provide for a precise recovery of lost margin and therefore will vary in their results based not only on the magnitude of weather variation during the total WNA period but also on the variation for each month.



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RGC RESOURCES, INC. AND SUBSIDIARIES

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 carrying cost revenue as financing costs are lower. As a result of the lower commodity price of natural gas delivered into storage during last year's summer storage injections, the average cost of gas in storage during the quarter and fiscal year-to-date declined by 24% and 26%, respectively, when compared to the same periods last year. The decline in the average value of inventory resulted in a reduction of \$127,000 in carrying cost revenues for the quarter and \$244,000 for the six month period compared to the same periods last year.

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.

**Results of Operations**

**Three Months Ended March 31, 2013:**

Net income increased by \$215,400 for the quarter ended March 31, 2013 compared to the same period last year. Implementation of a non-gas rate increase and colder weather more than offset higher expenses and the absence of a WNA accrual.

RGC RESOURCES, INC. AND SUBSIDIARIES

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

|                                  | Three Months Ended   |                      |                     |            |
|----------------------------------|----------------------|----------------------|---------------------|------------|
|                                  | 2013                 | March 31,<br>2012    | Increase            | Percentage |
| <b>Operating Revenues</b>        |                      |                      |                     |            |
| Gas Utilities                    | \$ 23,776,730        | \$ 21,021,336        | \$ 2,755,394        | 13%        |
| Other                            | 398,908              | 268,891              | 130,017             | 48%        |
| <b>Total Operating Revenues</b>  | <b>\$ 24,175,638</b> | <b>\$ 21,290,227</b> | <b>\$ 2,885,411</b> | <b>14%</b> |
| <b>Delivered Volumes</b>         |                      |                      |                     |            |
| Regulated Natural Gas (DTH)      |                      |                      |                     |            |
| Residential and Commercial       | 3,202,757            | 2,384,602            | 818,155             | 34%        |
| Transportation and Interruptible | 815,187              | 790,395              | 24,792              | 3%         |
| <b>Total Delivered Volumes</b>   | <b>4,017,944</b>     | <b>3,174,997</b>     | <b>842,947</b>      | <b>27%</b> |

Heating Degree Days (Unofficial) 2,129 1,567 562 36%

Total operating revenues for the three months ended March 31, 2013, compared to the same period last year, increased primarily due to a 27% increase in total natural gas deliveries associated with a 36% increase in heating degree days, partially offset by lower natural gas commodity prices. The per unit cost of natural gas reflected in the cost of sales decreased by 11% compared to last year.

|                           | Three Months Ended  |                     |                   |            |
|---------------------------|---------------------|---------------------|-------------------|------------|
|                           | 2013                | March 31,<br>2012   | Increase          | Percentage |
| <b>Gross Margin</b>       |                     |                     |                   |            |
| Gas Utilities             | \$ 9,431,252        | \$ 8,984,049        | \$ 447,203        | 5%         |
| Other                     | 154,475             | 134,473             | 20,002            | 15%        |
| <b>Total Gross Margin</b> | <b>\$ 9,585,727</b> | <b>\$ 9,118,522</b> | <b>\$ 467,205</b> | <b>5%</b>  |

Regulated natural gas margins from utility operations increased from the same period last year primarily as a result of the implementation of a non-gas rate increase and higher delivered volumes more than offsetting a reduction in inventory carrying cost revenues. The increased natural gas base rates were effective for service rendered on and after November 1, 2012 and were designed to provide \$649,639 in additional annual non-gas revenues, split between the customer base charge component and volumetric components, as provided for in the final order issued by the SCC. The additional margin generated by the significant increase in total natural gas deliveries due to much colder weather was mostly offset by last year's accrual of WNA

RGC RESOURCES, INC. AND SUBSIDIARIES

revenues for the quarter. As discussed above, the current WNA period ended March 31, 2013 resulted in weather that was less than 3% warmer than normal, which fell within the 3% weather band, thereby resulting in the reversal of the \$182,000 accrual made December 31, 2012. Last year, the WNA period ended March 31, 2012 had weather that was 22% warmer than normal resulting in an accrual of \$1,163,000 for the quarter. As a result, WNA revenues declined by \$1,345,000 while at the same time total residential and commercial natural gas deliveries increased by 818,155 decatherms, or 34%, due to a 36% increase in the total number of heating degree days for the period. Industrial volumes, which tend to be less weather sensitive than residential and commercial volumes, reflected a 3% increase primarily due to weather.

The components of the gas utility margin increase are summarized below:

**Net Margin Increase Gas Utilities**

|                      |                   |
|----------------------|-------------------|
| Customer Base Charge | \$ 48,630         |
| WNA                  | (1,344,845)       |
| Carrying Cost        | (126,790)         |
| Volumetric           | 1,804,677         |
| SAVE Plan            | 69,257            |
| Other                | (3,726)           |
| <b>Total</b>         | <b>\$ 447,203</b> |

Other margins increased by \$20,002 over the same period last year primarily due to work related to a one-time contract that will be completed in the Company's third fiscal quarter. More than half of the revenues and margins included under the caption of "Other" are subject to variations in the level of activity and generally are associated with service contracts that have a limited duration and are subject to renewal on an annual or semi-annual basis. Current service contracts extend through the remainder of the fiscal year; however, any continuation beyond fiscal 2013 is uncertain.

Operation and maintenance expenses were nearly unchanged from the same period last year as higher corporate insurance premiums and labor costs offset increases in capitalized overheads and lower professional services. Corporate property and liability insurance increased by \$24,000 due to higher premiums and increased general liability coverage limits. Operation and maintenance labor costs increased \$33,000 due to an increase in office personnel levels. Professional services declined by \$30,000 primarily due to legal expenses in the prior year related to the propane lawsuit. The remaining differences in operation and maintenance expenses were related to a \$23,000 increase in capitalized overheads and various other minor fluctuations in other expenses.

General taxes increased by \$35,328, or 10%, primarily due to higher property taxes associated with increases in utility property.

RGC RESOURCES, INC. AND SUBSIDIARIES

Depreciation expense increased by \$56,989, or 5%, on a corresponding increase in utility plant investment primarily due to the distribution pipeline replacement program.

Other income (expense), net, moved from an income position to a net expense position due to the payoff of the note receivable from ANGD, LLC on February 1, 2013 as discussed in Note 4.

Interest expense remained virtually unchanged as the Company's total debt position has remained at the \$28,000,000 level. The Company briefly accessed its line-of-credit in December and January to meet its cash needs.

Income tax expense increased by \$137,799, which corresponds to the increase in pre-tax income for the quarter. The effective tax rate was 38% for the current period and prior period.

**Six Months Ended March 31, 2013:**

Net income decreased by \$65,359 for the six months ended March 31, 2013 compared to the same period last year. Higher operation and maintenance expenses and depreciation more than offset implementation of a non-gas rate increase.

The table below reflects operating revenues, volume activity and heating degree days.

|                                  | Six Months Ended     |                      | Increase            | Percentage |
|----------------------------------|----------------------|----------------------|---------------------|------------|
|                                  | 2013                 | March 31,<br>2012    |                     |            |
| <b>Operating Revenues</b>        |                      |                      |                     |            |
| Gas Utilities                    | \$ 42,235,469        | \$ 39,194,781        | \$ 3,040,688        | 8%         |
| Other                            | 686,761              | 594,622              | 92,139              | 15%        |
| <b>Total Operating Revenues</b>  | <b>\$ 42,922,230</b> | <b>\$ 39,789,403</b> | <b>\$ 3,132,827</b> | <b>8%</b>  |
| <b>Delivered Volumes</b>         |                      |                      |                     |            |
| Regulated Natural Gas (DTH)      |                      |                      |                     |            |
| Residential and Commercial       | 5,209,908            | 4,189,221            | 1,020,687           | 24%        |
| Transportation and Interruptible | 1,551,247            | 1,530,206            | 21,041              | 1%         |
| <b>Total Delivered Volumes</b>   | <b>6,761,155</b>     | <b>5,719,427</b>     | <b>1,041,728</b>    | <b>18%</b> |

|                                  |       |       |     |     |
|----------------------------------|-------|-------|-----|-----|
| Heating Degree Days (Unofficial) | 3,607 | 2,895 | 712 | 25% |
|----------------------------------|-------|-------|-----|-----|

Total operating revenues for the six months ended March 31, 2013 compared to the same period last year increased due to significant increases in delivered volumes partially offset by lower cost of natural gas and the absence of WNA revenues. Total natural gas deliveries rose by 18% due to a 25% increase in heating degree days. In addition, declining natural gas commodity prices resulted in a 9% per unit reduction in the cost of natural gas reflected in cost of sales. Other revenues increased by 15%.

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|                        | Six Months Ended  |                   | Increase/<br>(Decrease) | Percentage |
|------------------------|-------------------|-------------------|-------------------------|------------|
|                        | 2013              | March 31,<br>2012 |                         |            |
| <b>Gross Margin</b>    |                   |                   |                         |            |
| Gas Utilities          | \$ 17,239,530     | \$ 16,944,719     | \$ 294,811              | 2%         |
| Other                  | 282,680           | 303,430           | (20,750)                | -7%        |
| <br>Total Gross Margin | <br>\$ 17,522,210 | <br>\$ 17,248,149 | <br>\$ 274,061          | <br>2%     |

Regulated natural gas margins from utility operations increased slightly over the same period last year due to several offsetting factors. Residential and commercial volumes (which tend to be more weather sensitive than transportation and industrial volumes) increased by 24% corresponding to a 25% increase in the number of heating degree days for the period. Industrial volumes were nearly unchanged from the same period last year. The margin increase generated by the higher volume activity, however, was mostly offset by the \$1,740,000 WNA accrual last year due to much warmer weather as discussed above. In addition, the margin increase attributable to the implementation of the non-gas rate increase offset the reduction in inventory carrying cost revenues. The components of the regulated margin increase are summarized below:

**Net Margin Increase Gas Utilities**

|                      |                |
|----------------------|----------------|
| Customer Base Charge | \$ 112,704     |
| WNA                  | (1,740,151)    |
| Carrying Cost        | (243,809)      |
| Volumetric           | 2,111,370      |
| SAVE Plan            | 69,257         |
| Other                | (14,560)       |
| <br>Total            | <br>\$ 294,811 |

Other margins declined by \$20,750 primarily due to reductions in the level of other services contract work during the first quarter.

Operation and maintenance expenses increased by \$196,392, or 3%, for the six-month period ended March 31, 2013 compared to the same period last year. Higher labor, contracted services, professional services and corporate insurance costs more than offset increases in capitalized overheads. Labor and contracted services increased by \$173,000 primarily due to timing of leak surveys, pipeline right-of-way clearing and similar services with most of the work completed during the first quarter. Professional services increased by \$27,000 associated mainly with higher costs related to transitioning from smaller reporting company to accelerated filer status and information technology consulting assistance incurred during the first quarter. Corporate

RGC RESOURCES, INC. AND SUBSIDIARIES

property and liability insurance increased by \$48,000 due to higher premiums and increased general liability coverage limits. These higher costs were partially offset by greater capitalization of overheads due to higher level of capital expenditures.

General taxes increased \$55,983, or 8%, for the six-month period ended March 31, 2013 compared to the same period last year related to higher property taxes associated with increases in utility property.

Depreciation expense increased by \$122,363, or 6%, corresponding to the increase in utility plant investment.

Other income (expense), net, was nearly unchanged as decreases in certain expenses offset the reduction in interest income due to the payoff of the ANGD note in February 2013.

Interest expense remained nearly unchanged as borrowing under the Company's line-of-credit was minimal during the period.

Income tax expense declined by \$33,615, or 1%, which corresponds to the decrease in pre-tax income. The effective tax rate was 38% for 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, 2012.

**Asset Management**

Roanoke Gas uses a third party as an 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 October 2013. The Company is currently in process of rebidding the contract.

RGC RESOURCES, INC. AND SUBSIDIARIES**Regulatory**

On November 1, 2012, Roanoke Gas Company placed into effect new base rates, subject to refund, that provide for approximately \$1,840,000 in additional annual non-gas revenues. On March 21, 2013, the Company reached a stipulated agreement with the SCC staff for a non-gas rate award in the amount of \$649,639 in additional annual non-gas revenues. On April 16, 2013, the SCC issued its final order approving the increase in annual non-gas revenues agreed to in the stipulation. The Company has recorded a provision for rate refund, including interest associated with customer billings, for the difference between the rates placed into effect on November 1 and those approved in the final order. Refunds to customers will be made during the Company's May billing cycle.

Beginning in January 2013, the Company started billing a separate rider on customer bills related to its SAVE (Steps to Advance Virginia's Energy) Plan. The SCC approved the Company's SAVE Plan application on July 25, 2012. The SAVE plan is designed to facilitate the accelerated replacement of aging natural gas infrastructure assets by providing the Company with a means to recover depreciation and related expenses and return on rate base of the additional capital investment without the filing of a formal application for an increase in non-gas base rates. The SAVE Plan provides the Company with a more timely mechanism for recovering the cost of its renewal program. Previously, the Company could only recover these expenses and return on rate base on a prospective basis after filing and implementing a non-gas rate increase.

**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 capital raised through the Company's Dividend Reinvestment and Stock Purchase Plan (DRIP).

Cash and cash equivalents increased by \$3,271,052 for the six-month period ended March 31, 2013 compared to an \$8,101,392 increase for the same period last year. The significant reduction in cash flow was primarily due to the special \$1.00 per share dividend paid by the Company on December 17, 2012, and to a lesser extent, to less cash generated by operations and higher capital expenditures related to the Company's pipeline renewal program. The following table summarizes the categories of uses of cash:

|  | Six Months Ended |               |
|--|------------------|---------------|
|  | March 31,        |               |
|  | 2013             | 2012          |
| <b>Cash Flow Summary Six Months Ended:</b> |                  |               |
| Provided by operating activities           | \$ 12,339,835    | \$ 13,215,506 |
| Used in investing activities               | (4,438,570)      | (4,021,595)   |
| Used in financing activities               | (4,630,213)      | (1,092,519)   |
| <br>                                       |                  |               |
| Increase in cash and cash equivalents      | \$ 3,271,052     | \$ 8,101,392  |

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RGC RESOURCES, INC. AND SUBSIDIARIES

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 all 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.

For the six months ended March 31, 2013, cash flow provided by operations decreased by \$875,671 from the prior year primarily due to a significant increase in accounts receivable on higher billed and unbilled natural gas deliveries due to a much colder March as compared to the prior year combined with a smaller reduction in storage inventory balances. These reductions in operating cash flows were partially offset by an increase in accounts payable related to significantly higher natural gas purchases associated with the colder March weather.

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 to a lesser degree, expanding its natural gas system to meet the demands of customer growth. Cash flows used in investing activities increased by \$416,975 due to an increased level of capital expenditures. Total capital expenditures were \$4,441,536 and \$4,024,345 for the six-month periods ended March 31, 2013 and 2012, respectively. The increase in capital expenditures is attributable to the continued focus by the Company on its pipeline renewal program. The Company's current plan includes a five to seven year time horizon to finish replacing the remaining bare steel and cast iron pipe within its natural gas distribution system. In order to meet this goal, the Company expects capital expenditures to remain at elevated levels for the next few years. The depreciation add back to operating cash flows is expected to provide approximately 50% of the funding for the current year's projected capital expenditures, with the balance of funding dependent on other sources including revenue from the SAVE Plan, net income, available cash and corporate borrowing activity.

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



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RGC RESOURCES, INC. AND SUBSIDIARIES

arrangement to fund seasonal working capital needs as well as provide temporary financing for capital projects. Cash flow used in financing activities increased by \$3,537,694, from \$1,092,519 to \$4,630,213, primarily due to the special \$1.00 per share dividend paid by the Company on December 17, 2012. The special dividend totaled \$4,675,337, of which \$425,630 was returned to the Company under the DRIP plan to purchase 21,951 shares of stock. Most of the remaining difference relates to proceeds received from the \$865,000 payoff of the balance of the ANGD note in February. The Company accessed its line-of-credit for the first time since February 2009 to provide temporary financing during the winter season. The Company has been able to finance operations with its operating cash flow without needing to access its line-of-credit over the last few years as cash flows have been positively affected by declining natural gas prices resulting in lower natural gas storage balances and accounts receivable in addition to accelerated and bonus tax depreciation deductions which have limited federal corporate income tax payments over the last few years. However, with natural gas prices appearing to have leveled off and an increasing focus on the Company's pipeline replacement program, the Company expects to utilize its line-of-credit more often to provide funding for its operations.

Effective March 31, 2013, 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 the multi-tiered borrowing limits to accommodate seasonal borrowing demands and minimize overall borrowing costs with available limits ranging from \$1,000,000 to \$7,000,000 during the term of the agreement. The line-of-credit agreement will expire March 31, 2014, unless extended. The Company anticipates being able to extend or replace the line-of-credit upon expiration; however, there is no guarantee that the line-of-credit will be extended or replaced under the same or equivalent terms currently in place.

Effective March 31, 2013, the Company also executed an unsecured term note in the amount of \$15,000,000. This term note essentially extends the maturity date of the prior term note to March 31, 2014 and retains all other terms and conditions provided for in the original promissory note. The Company anticipates being able to renew this note on comparable terms as currently in place until such time the note co-terminates with the corresponding interest rate swap on November 30, 2015.

At March 31, 2013, the Company's consolidated capitalization, including notes payable, was 64% equity and 36% debt.

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RGC RESOURCES, INC. AND SUBSIDIARIES

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 long-term and 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, 2013, the Company had no balances outstanding under its line-of-credit. The Company did, however, access its line-of-credit during the period to provide temporary working capital funding. A hypothetical 100 basis point increase in market interest rates applicable to the Company's variable rate debt outstanding during the period would have resulted in an increase in interest expense for the period of less than \$1,000. The Company also has a \$15,000,000 note payable and a \$5,000,000 intermediate term variable rate note both of which are currently being hedged by fixed rate interest swaps. The remaining \$8,000,000 balance of the 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, 2013, the Company had no outstanding derivative instruments to hedge the price of natural gas. The Company had approximately 865,521 decatherms of gas in storage, including LNG, at an average price of \$3.64 per decatherm. The SCC currently allows for full recovery of prudent costs associated with natural gas purchases, and any additional costs or benefits associated with the settlement of the derivative contracts and other price hedging techniques are passed through to customers when realized through the PGA mechanism.

RGC RESOURCES, INC. AND SUBSIDIARIES

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, 2013, 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, 2013.

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, 2013 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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RGC RESOURCES, INC. AND SUBSIDIARIES

Part II Other Information

ITEM 1 LEGAL PROCEEDINGS

No changes.

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 principal amount of \$7,000,000 by Roanoke Gas in favor of Wells Fargo Bank, N.A. dated March 31, 2013 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on April 2, 2013). |
| 10.2   | Promissory Note in the original amount of \$15,000,000 by Roanoke Gas Company in favor of Wells Fargo Bank, N.A. dated March 31, 2013 (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on April 2, 2013).       |

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RGC RESOURCES, INC. AND SUBSIDIARIES

- 10.3 First Amendment to Credit Agreement by and between Roanoke Gas Company and Wells Fargo Bank, N.A. (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on April 2, 2013).
- 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, 2013, formatted in XBRL (eXtensible Business Reporting Language); (i) Condensed Consolidated Balance Sheets at March 31, 2013 and September 30, 2012, (ii) Condensed Consolidated Statements of Income for the three months and six months ended March 31, 2013 and 2012; (iii) Condensed Consolidated Statements of Comprehensive Income for the three months and six months ended March 31, 2013 and 2012; (iv) Condensed Consolidated Statements of Cash Flows for the six months ended March 31, 2013 and 2012, 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.

\*\* Pursuant to Rule 406T or Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

RGC RESOURCES, INC. AND SUBSIDIARIES

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 10, 2013

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