RGC RESOURCES INC
Form 10-Q
May 10, 2007

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, 2007

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 Incorporation or Organization)	**(I.R.S. Employer 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 **x** No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerarted-filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer **x**

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

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, 2007
Common Stock, $5 Par Value	2,163,972

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

	March 31, 2007	September 30, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 4,930,977	$ 1,490,141
Accounts receivable - (less allowance for uncollectibles of $808,856 and $34,980, respectively)	14,457,081	5,217,009
Materials and supplies	682,799	649,578
Gas in storage	7,920,610	23,331,703
Prepaid income taxes		928,820
Deferred income taxes	2,985,040	2,436,516
Under-recovery of gas costs		611,435
Other	917,726	474,355
Total current assets	31,894,233	35,139,557
Utility Property:		
In service	118,282,655	114,981,414
Accumulated depreciation and amortization	(39,268,846)	(37,797,548)
In service, net	79,013,809	77,183,866
Construction work in progress	1,447,424	1,855,743
Utility Plant, Net	80,461,233	79,039,609
Other assets	451,429	483,406
Total Assets	$ 112,806,895	$ 114,662,572

See notes to condensed consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

	March 31, 2007	September 30, 2006
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Borrowings under lines of credit	$ 1,981,000	$ 6,613,000
Dividends payable	660,011	643,067
Accounts payable	9,297,655	9,451,343
Customer credit balances	2,200,159	4,403,833
Income taxes payable	1,088,553	
Customer deposits	1,738,201	1,293,019
Accrued expenses	3,767,612	3,701,530
Over-recovery of gas costs	3,295,030	2,112,256
Fair value of marked to market transactions	60,167	1,621,439
Total current liabilities	24,088,388	29,839,487
Long-term Debt, Excluding Current Maturities	30,000,000	30,000,000
Deferred Credits and Other Liabilities:		
Asset retirement obligations	2,741,278	2,682,138
Regulatory cost of retirement obligations	5,973,504	5,547,642
Deferred income taxes	5,893,971	5,933,626
Deferred investment tax credits	149,565	164,811
Total deferred credits and other liabilities	14,758,318	14,328,217
Stockholders Equity:		
Common stock, $5 par value; authorized, 10,000,000 shares; issued and outstanding 2,160,796 and 2,138,595 shares, respectively	10,803,980	10,692,975
Preferred stock, no par, authorized, 5,000,000 shares; no shares issued and outstanding		
Capital in excess of par value	14,949,106	14,521,812
Retained earnings	18,244,431	15,282,909
Accumulated other comprehensive loss	(37,328)	(2,828)
Total stockholders equity	43,960,189	40,494,868
Total Liabilities and Stockholders Equity	$ 112,806,895	$ 114,662,572

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE-MONTH AND SIX-MONTH PERIODS ENDED MARCH 31, 2007 AND 2006

UNAUDITED

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2007	2006	2007	2006
Operating Revenues:				
Gas utilities	$ 42,492,873	$ 38,337,210	$ 72,216,093	$ 82,065,126
Other	118,865	120,786	388,689	312,227
Total operating revenues	42,611,738	38,457,996	72,604,782	82,377,353
Cost of Sales:				
Gas utilities	32,812,492	29,554,713	54,461,070	65,643,012
Other	30,160	53,376	210,708	142,450
Total cost of sales	32,842,652	29,608,089	54,671,778	65,785,462
Gross Margin	9,769,086	8,849,907	17,933,004	16,591,891
Other Operating Expenses:				
Operations	3,017,315	2,884,002	5,904,835	5,805,731
Maintenance	319,092	348,447	666,372	740,864
General taxes	506,937	509,861	931,720	964,584
Depreciation and amortization	1,130,391	1,066,968	2,255,782	2,133,935
Total other operating expenses	4,973,735	4,809,278	9,758,709	9,645,114
Operating Income	4,795,351	4,040,629	8,174,295	6,946,777
Other Expenses (Income), net	(348)	7,916	(2,016)	13,443
Interest Expense	606,610	681,480	1,266,243	1,345,135
Income from Continuing Operations Before Income Taxes	4,189,089	3,351,233	6,910,068	5,588,199
Income Tax Expense from Continuing Operations	1,596,385	1,278,769	2,631,849	2,133,389
Income from Continuing Operations	2,592,704	2,072,464	4,278,219	3,454,810
Discontinued operations:				
Income from discontinued operations, net of income taxes of $51,769 and $94,499, respectively		84,610		154,446
Net Income	2,592,704	2,157,074	4,278,219	3,609,256
Other Comprehensive Income (Loss), net of tax	(23,762)	411,479	(34,500)	433,865
Comprehensive Income	$ 2,568,942	$ 2,568,553	$ 4,243,719	$ 4,043,121
Basic Earnings Per Common Share:				
Income from continuing operations	$ 1.20	$ 0.98	$ 1.99	$ 1.64
Discontinued operations		0.04		0.07

Net income	$	1.20	$	1.02	$	1.99	$	1.71
Diluted Earnings Per Common Share:								
Income from continuing operations	$	1.20	$	0.98	$	1.98	$	1.63
Discontinued operations				0.04				0.07
Net income	$	1.20	$	1.02	$	1.98	$	1.70

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, 2007 AND 2006

UNAUDITED

	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income from continuing operations	$ 4,278,219	$ 3,454,810
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	2,381,212	2,254,327
Cost of removal of utility plant, net	(102,906)	(118,254)
Changes in assets and liabilities which provided cash, exclusive of changes and noncash transactions shown separately	5,698,056	1,786,299
Net cash provided by continuing operating activities	12,254,581	7,377,182
Net cash provided by discontinued operations		154,446
Net cash provided by operating activities	12,254,581	7,531,628
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to utility plant	(3,420,291)	(3,356,760)
Proceeds from disposal of utility property		1,686
Net cash used in investing activities	(3,420,291)	(3,355,074)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of long-term debt		17,000,000
Retirement of long-term debt and capital leases		(13,000,000)
Net repayments under line-of-credit agreements	(4,632,000)	(7,509,000)
Proceeds from issuance of common stock	538,299	546,372
Cash dividends paid	(1,299,753)	(1,251,895)
Net cash used in financing activities	(5,393,454)	(4,214,523)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,440,836	(37,969)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	1,490,141	1,349,518
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 4,930,977	$ 1,311,549
SUPPLEMENTAL INFORMATION:		
Cash paid during the year for:		
Interest	$ 1,243,098	$ 1,346,216
Income taxes net of refunds	1,196,794	1,200,415

See notes to condensed consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

1. 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, 2007 and the results of its operations for the three months and six months ended March 31, 2007 and 2006 and its cash flows for the six months ended March 31, 2007 and 2006. The results of operations for the three months and six months ended March 31, 2007 are not indicative of the results to be expected for the fiscal year ending September 30, 2007 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.

2. The condensed consolidated interim financial statements and condensed notes are presented as permitted by Form 10-Q and do not contain certain information included in the Company s annual consolidated financial statements and notes thereto. 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.

3. Certain reclassifications were made to prior year financial statements to place them on a basis consistent with current year presentation with regard to discontinued operations, utility property, nonutility property, accrued expenses and refunds from suppliers-due customers.

4. 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.

5. On February 16, 2007, RGC Resources, Inc. (Resources or Company) entered into a Purchase and Sale Agreement with ANGD LLC (ANGD) for the sale of all of the capital stock of Bluefield Gas Company (Bluefield), a wholly owned subsidiary of Resources, to ANGD. Bluefield represents approximately 3,800 of Resources 61,400 natural gas customers. The sales price will be equal to the book value of Bluefield s net assets on the date of closing, subject to mutually agreed upon or arbitrated purchase price adjustments determined subsequent to the closing date but no later than 230 days after Closing. In connection with the sale, (i) certain real estate will be distributed to the Company (or its designee) prior to Closing, (ii) inter-company receivables or payables existing between Bluefield and the Company (including its other affiliates) will be settled as of Closing, and (iii) the Company will pay off Bluefield s outstanding debt at Closing out of the sales proceeds. Resources anticipates using the remaining proceeds from the sale to provide additional capital investment for its other wholly owned regulated natural gas subsidiary, Roanoke Gas Company (Roanoke).

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

Also on February 16, 2007, Roanoke entered into an Asset Purchase and Sale Agreement with Appalachian Natural Gas Distribution Company (Appalachian) for the sale of Roanoke s natural gas distribution assets located in the Town of Bluefield and the County of Tazewell, Virginia, (Bluefield division of Roanoke Gas Company) to Appalachian, which is a wholly owned subsidiary of ANGD. Approximately 1,200 of Roanoke s 57,600 customers are represented by these assets. The sales price will be equal to the book value of net plant plus 1% and the book value of accounts receivable, natural gas inventory, and certain other listed current assets, subject to mutually agreed upon or arbitrated purchase price adjustments determined subsequent to the closing date but no later than 230 days after Closing. $1,300,000 of such sale price shall be payable in the form of a promissory note from ANGD with a 5-year term and a 15-year amortization schedule with annual principal payments and quarterly interest payments at a 10% interest rate. Roanoke anticipates using the proceeds from the sale to retire debt.

The Board of Directors approved the Purchase and Sale Agreements of Bluefield Gas Company and the Bluefield division of Roanoke Gas Company for several reasons. The management time and effort required to oversee operations in West Virginia is significantly disproportionate to the size of the operation. The regulatory environment hindered the ability to recover increasing expenses on a timely basis resulting in net losses from those operations in each of the last four fiscal years. The economic conditions in southern West Virginia have lead to a loss of population and gas customers in the West Virginia service area. Management believes that the net proceeds realized from these transactions can be reinvested in the Roanoke Gas operations and ultimately provide a better return for the Company than could be realized in the Bluefield operations.

The transactions contemplated by the purchase agreements require the approval of the respective regulatory commissions: the West Virginia Public Service Commission for the sale of Bluefield and the Virginia State Corporation Commission for the sale of Virginia assets. Furthermore, the closing of each of the purchase agreements is conditioned upon such approval of the other transaction. Therefore, the parties intend that either both transactions would close or neither would close. SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, requires that long-lived assets or disposal groups to be sold shall be classified as held for sale in the period in which certain criteria are met. Paragraph 30.d. of SFAS No. 144 specifies The sale of the asset (disposal group) is probable, and transfer of the asset (disposal group) is expected to qualify for recognition as a completed sale within one year Because the approval of both commissions is required to complete the transaction and due to the uncertainty as to how each Commission will rule on the applications, the Company does not believe the proposed transaction meets the probable definition requirement of SFAS No 144 in classifying the assets contemplated in the transactions as held for sale. Therefore, the results of operations of both Bluefield Gas and the Bluefield, Virginia division of Roanoke Gas are not reflected as discontinued operations. If the requirements of SFAS No. 144 had been met, the effect on the financial statements included in this quarterly report of the proposed transactions would be as presented below.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
Bluefield Gas				
Revenues	$ 5,039,625	$ 4,969,574	$ 8,615,025	$ 10,504,800
Pretax Operating Income	309,762	248,017	432,179	350,984
Continuing Costs	192,134	167,444	351,754	342,545
Income Tax Expense	(195,934)	(161,702)	(304,816)	(269,298)
Discontinued Operations	$ 305,962	$ 253,759	$ 479,117	$ 424,231

The carrying amounts of the major classes of assets and liabilities subject to the purchase agreements for the period ended March 31, 2007 are as follows:

	As of March 31, 2007
Current Assets	$ 522,071
Utility Property	9,134,146
Other Assets	63,442
Total Assets	$ 9,719,659
Current Liabilities	$ 3,649,552
Debt	2,000,000
Deferred Credits and Other Liabilities	1,136,121
Total Liabilities	$ 6,785,673

Each of the purchase agreements provides at closing for a services agreement to be executed whereby Resources and Roanoke will provide certain customer billing, gas control, regulatory and other administrative services for Bluefield and Appalachian on mutually agreeable terms.

Resources does not anticipate the closing of the purchase agreements to result in a material gain or loss in the consolidated results of operations.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

6. In July 2006, the company entered into an asset purchase and sale agreement for the sale of the assets relating to its Highland Energy gas marketing business. The assets sold included the gas supply contracts between Highland Energy and its customers and related business records. The operations associated with the energy marketing business were reclassified as Discontinued Operations in accordance with the provisions of SFAS No. 144. The discontinued operations related to the sale of Highland Energy contracts for the three and six months ended March 31, 2006 are reflected below.

	Three Months Ended March 31,		Six Months Ended March 31,	
	2007	2006	2007	2006
Highland Energy				
Revenues		$ 7,323,070		$ 16,167,712
Pretax Operating Income		123,733		219,826
Continuing Costs		12,646		29,119
Income Tax Expense		(51,769)		(94,499)
Discontinued Operations		$ 84,610		$ 154,446

7. Since 2003, Roanoke Gas Company has had in place a weather normalization adjustment tariff (WNA) based on a weather occurrence band around the most recent 30-year temperature average. The weather band provides approximately a 6 percent range around normal weather, whereby if the number of heating-degree days (an industry measure by which the average daily temperature falls below 65 degrees) fell within the weather band, no adjustment would be made. However, if the number of heating-degree days were below the weather band, the Company would add a surcharge to customer bills equal to the equivalent margin lost beyond the weather band deficiency. Likewise, if the number of heating-degree days were above the weather band, the Company would credit customer bills equal to the excess margin realized above the weather band. The measurement period in determining the weather band extends from April through March. As of March 31, 2007, heating-degree days for the period April 2006 through March 2007 were approximately 12 percent less than the 30-year average. The Company recorded approximately $118,000 in additional revenues for the quarter and approximately $446,000 in additional revenues during the first six months to reflect the estimated impact of the WNA tariff for the difference in margin realized for weather between 12 percent and 6 percent warmer than the 30-year average. For the measurement period of April 2005 through March 2006, the heating-degree days were approximately 11 percent less than the 30-year average. As a result, the income statements for the three and six month periods ended March 31, 2006 include approximately $338,000 in additional revenues related to the application of the WNA tariff. The Company applied the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, in recording the estimated revenue.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

8. In April 2007, Roanoke Gas Company received the final rate order approving rates that provide for $1,667,940 in additional annual non gas revenues. Since October 23, 2006, Roanoke Gas Company had placed rates into effect providing for approximately $1.75 million in additional annual non-gas revenues subject to refund. As a result of this final order, Roanoke Gas Company has recorded a provision for refund of approximately $53,000 plus interest. The Company expects to complete the refund during the June billing cycle.

9. On March 22, 2007, the Company and Wachovia Bank renewed the Company s line-of-credit agreements. The new agreements maintain the same variable interest rates based upon 30 day LIBOR and continue the multi-tier level for borrowing limits to accommodate the Company s seasonal borrowing demands. The multi-tier approach will keep the Company s borrowing costs to a minimum by improving the level of utilization on its line-of-credit agreements and providing increased credit availability as borrowing requirements increase. Effective with the execution of the new agreements, the Company s total available limits under the lines-of-credit are as follows:

Beginning	Available Line of Credit
April 1, 2007	$ 10,000,000
July 16, 2007	15,000,000
September 16, 2007	23,000,000
November 16, 2007	27,000,000
February 16, 2008	22,000,000

The line-of-credit agreements will expire March 31, 2008, unless extended. The Company anticipates being able to extend or replace the credit lines upon expiration. At March 31, 2007, the Company had $1,981,000 outstanding under its lines-of-credit agreements.

10. The Company s risk management policy allows management to enter into derivatives for the purpose of managing 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 would seek to hedge include the price of natural gas and the cost of borrowed funds.

The Company has historically entered into futures, swaps and caps for the purpose of hedging the price of natural gas in order to provide price stability during the winter months. During the quarter ended March 31, 2007, the Company had settled all outstanding swap and price cap arrangements for the purchase of natural gas. Net income and other comprehensive income are not affected by the change in market value as any cost incurred or benefit received from these instruments is recoverable or refunded through the regulated natural gas purchased gas adjustment (PGA) mechanism. Both the Virginia State Corporation

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

Commission and the West Virginia Public Service Commission currently allow for full recovery of prudent costs associated with natural gas purchases, and any additional costs or benefits associated with the settlement of these instruments will be passed through to customers when realized.

The Company entered into an interest rate swap related to the $15,000,000 note issued in November 2005. The swap essentially converted the floating rate note based upon LIBOR into fixed rate debt with a 5.74 percent interest rate. The swap qualifies as a cash flow hedge with changes in fair value reported in other comprehensive income.

A summary of other comprehensive income and derivative activity is provided below:

Three Months Ended March 31, 2007

	Interest Rate Swap	Minimum Pension Liability	Total
Unrealized losses	$ (28,103)	$	$ (28,103)
Income tax benefit	10,668		10,668
Net unrealized losses	(17,435)		(17,435)
Transfer of realized gains to income	(10,198)		(10,198)
Income tax expense	3,871		3,871
Net transfer of realized gains to income	(6,327)		(6,327)
Net other comprehensive loss	$ (23,762)	$	$ (23,762)

Three Months Ended March 31, 2006

	Interest Rate Swap	Minimum Pension Liability	Total
Unrealized gains	$ 447,186	$ 196,227	$ 643,413
Income tax expense	(169,752)	(74,566)	(244,318)
Net unrealized gains	277,434	121,661	399,095
Transfer of realized losses to income	19,960		19,960
Income tax benefit	(7,576)		(7,576)
Net transfer of realized losses to income	12,384		12,384
Net other comprehensive income	$ 289,818	$ 121,661	$ 411,479

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

Six Months Ended March 31, 2007

	Interest Rate Swap	Minimum Pension Liability	Total
Unrealized losses	$ (35,027)	$	$ (35,027)
Income tax benefit	13,296		13,296
Net unrealized losses	(21,731)		(21,731)
Transfer of realized gains to income	(20,581)		(20,581)
Income tax expense	7,812		7,812
Net transfer of realized gains to income	(12,769)		(12,769)
Net other comprehensive loss	$ (34,500)	$	$ (34,500)
Fair value of marked to market transactions	$ (60,167)		$ (60,167)
Accumulated comprehensive loss	$ (37,328)		$ (37,328)

Six Months Ended March 31, 2006

	Interest Rate Swap	Minimum Liability Pension	Total
Unrealized gains	$ 286,989	$ 392,454	$ 679,443
Income tax expense	(108,941)	(149,133)	(258,074)
Net unrealized gains	178,048	243,321	421,369
Transfer of realized losses to income	20,141		20,141
Income tax benefit	(7,645)		(7,645)
Net transfer of realized losses to income	12,496		12,496
Net other comprehensive income	$ 190,544	$ 243,321	$ 433,865
Fair value of marked to market transactions	$ 320,736		$ 320,736
Accumulated comprehensive income (loss)	$ 198,985	(145,591)	$ 53,394

11. Basic earnings per common share for the three months and six months ended March 31, 2007 and 2006 are calculated by dividing net income by the weighted average common shares outstanding during the period. Diluted earnings per common share for the three months and six months ended March 31, 2007 and 2006 are calculated by dividing net income by the weighted average common shares outstanding during the period plus dilutive potential

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

common shares. Dilutive potential common shares are calculated in accordance with the treasury stock method, which assumes that proceeds from the exercise of all options are used to repurchase common stock at market value. The amount of shares remaining after the proceeds are exhausted represents the potentially dilutive effect of the securities. A reconciliation of the weighted average common shares and the diluted average common shares is provided below:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2007	**2006**	**2007**	**2006**
Weighted average common shares	2,157,532	2,114,012	2,152,741	2,108,996
Effect of dilutive securities:				
Options to purchase common stock	10,642	10,214	9,937	10,503
Diluted average common shares	2,168,174	2,124,226	2,162,678	2,119,499

12. The Company has both a defined benefit pension plan (the pension plan) and a post- retirement benefits plan (the post-retirement 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 post-retirement plan provides certain healthcare and supplemental life insurance benefits to retired employees who meet specific age and service requirements. Net pension plan and post-retirement plan expense recorded by the Company is detailed as follows:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2007	**2006**	**2007**	**2006**
Components of net periodic pension cost:				
Service cost	$ 101,227	$ 119,320	$ 202,454	$ 238,640
Interest cost	185,228	173,896	370,456	347,792
Expected return on plan assets	(172,816)	(157,068)	(345,632)	(314,136)
Recognized loss	18,050	60,077	36,100	120,154
Net periodic pension cost	$ 131,689	$ 196,225	$ 263,378	$ 392,450

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

	Three Months Ended March 31,		Six Months Ended March 31,	
	2007	2006	2007	2006
Components of post-retirement benefit cost:				
Service cost	$ 36,923	$ 42,468	$ 73,846	$ 85,301
Interest cost	125,461	125,060	250,922	248,021
Expected return on plan assets	(59,724)	(56,640)	(119,448)	(109,343)
Amortization of unrecognized transition obligation	47,223	49,434	94,446	108,759