RGC RESOURCES INC
Form ARS
December 19, 2008
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YEAR ENDED SEPTEMBER 30,	2008	2007
Operating Revenue - Natural Gas	$ 93,606,593	$ 89,175,661
Other Revenue	$ 1,030,233	$ 725,640
Net Income - Continuing Operations	$ 4,257,824	$ 3,765,669
Net Income (Loss) - Discontinued Operations	$ (36,690)	$ 40,540
Basic Earnings Per Share - Continuing Operations	$ 1.94	$ 1.74
Basic Earnings Per Share - Discontinued Operations	(0.02)	$ 0.02
Regular Dividend Per Share - Cash	$ 1.25	$ 1.22
Number of Customers - Natural Gas	55,689	55,420
Total Natural Gas Deliveries - DTH	9,251,254	9,538,229
Total Additions to Plant	$ 6,539,369	$ 6,004,190

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I am delighted to report EARNINGS OF $4.2 MILLION, **which reflects a 9 percent increase in earnings in a very difficult year for the U.S. economy and financial markets.**

I am delighted to report company earnings of $4.2 million, or $1.91 per average diluted share outstanding. This compares to per share earnings of $1.75 in 2007 and reflects a 9 percent increase in earnings in a very difficult year for the U.S. economy and the financial markets. I am also pleased to report that your Board of Directors elected to raise the annualized dividend rate to $1.28 per share effective with the February 1, 2009, quarterly dividend for shareholders of record on January 17, 2009. This is the Company s 12th dividend increase since 1995 and continues our 64-year record of consecutive quarterly dividend payments to shareholders.

Fiscal 2008 was another busy year for the Company. We sold our Bluefield Gas Company operations, settled a pending Roanoke Gas Company rate case increase in March for $416,000, filed another increase request in September for $1.2 million, carried out a record level of pipeline replacements, and operated through the second most volatile year of natural gas commodity prices in history. Fiscal 2008 was also one of the most volatile stock market and credit-constrained years in recent history.

As I indicated to shareholders last year, I believe the sale of the Bluefield Gas Company operations was an appropriate strategic move for the Company. The sale allowed us to redeploy capital to the Roanoke Gas Company utility system, which has far greater customer growth potential and a much better financial performance record. Our earnings growth in 2008, combined with our enhanced pipeline replacement program, supports the appropriateness of that strategic decision.

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In 2008, our service area experienced a significant slowdown in new home construction, and we consequently had slower customer growth related to the overall economic slowdown and depressed housing market. However, we used the slowdown in new construction as an opportunity to enhance our distribution system renewal program. We installed over 9 miles of new plastic mains associated with our bare steel and cast iron replacement program. We also replaced 684 bare steel main-to-meter service lines with new plastic service lines. Our miles of pipeline installed associated with system renewal increased by over 40 percent and our volume of bare steel service line replacements nearly doubled compared to 2007. A significant portion of the September 2008 rate increase application to the Virginia State Corporation Commission is related to the incremental depreciation expense and carrying cost associated with the higher level of distribution system investment.

The sale of the Bluefield Gas Company operations allowed us

to redeploy capital to the Roanoke Gas Company utility system

which has FAR GREATER CUSTOMER GROWTH POTENTIAL

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Fiscal 2008 was an extremely volatile period for energy commodities. Crude oil prices reached all-time price highs, climbing to over $140 a barrel while natural gas spiked to over $14 a decatherm. Prices then plunged to roughly $60 a barrel for oil and to under $7 a decatherm for natural gas. A rapidly devaluing U.S. dollar, combined with political upheaval in oil producing regions and strong oil demand, led to a real or perceived oil shortage and price extremes. Natural gas prices followed, in spite of increasing domestic production with adequate storage levels. However, in a matter of weeks, oil commodity prices collapsed, as did the perception of demand with the growing worldwide recession. Natural gas prices also dropped dramatically as the market responded to declining demand, increasing domestic production and strong storage levels leading into the winter months.

Prices have now fallen so fast that we may have set ourselves up for another boom/bust cycle, which could lead to a decline in exploration and production, followed by another supply squeeze and price spike when the economy recovers and energy demand again grows. I believe the long-term outlook for energy prices

RGC installed OVER 9 MILES

OF NEW PLASTIC MAINS

associated with our bare steel

and cast iron replacement program.

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Our miles of pipeline installed associated with system renewal

INCREASED BY OVER 40 PERCENT **and our volume of bare steel**

service line replacements nearly DOUBLED COMPARED TO 2007.

will be volatile, but steadily trending higher, particularly given continued world population and long-term energy demand growth. Pressure on natural gas demand and prices will also increase when climate change legislation is enacted by the U.S. Congress and signed into law by the new president. Burning natural gas produces roughly half of the carbon dioxide emissions of coal, so it will become an increasingly favored fuel for electricity generation as electric utilities try to lower their carbon dioxide emissions to comply with new legislative mandates.

The Company so far has weathered the financial crisis and economic decline without disruption. Our working capital credit lines and banking relationships have remained in place and strong. We successfully replaced $5 million of retired long-term debt at a competitive interest rate just after the fiscal year ended. I am also pleased with how well our stock price has held up, even if it has been somewhat more volatile during the extreme stock market swings. The economic slowdown may, however, have more impact on us in 2009 if our larger industrial customers are forced to cut back

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operations in response to reduced demand for their products. We experienced some industrial demand decline early in the first quarter of 2009.

We are pleased to provide you with our 2008 annual report reflecting strong earnings performance. Our annual report this year explores how we are meeting our customers needs by focusing on basics, and is reflective of our long-term commitment to strengthening our energy distribution infrastructure. We look forward to many more years of providing safe and reliable natural gas service to our customers and consistently competitive returns to our shareholders. On behalf of the Board of Directors and employees of RGC Resources, Inc., I thank you for your continuing interest in our operations and for your decision to be a shareholder.

Sincerely,

John B. Williamson, III

Chairman, President and CEO

RGC has WEATHERED

THE FINANCIAL CRISIS

AND ECONOMIC DECLINE

WITHOUT DISRUPTION.

Our working capital credit lines and

banking relationships have remained

IN PLACE AND STRONG.

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Officers and Board of Directors

OFFICERS

John B. Williamson, III

Chairman of the Board, President and Chief Executive Officer *(1)(2)(3)(4)*

John S. D Orazio

Vice President and Chief Operating Officer *(2)(3)(4)*

Howard T. Lyon

Vice President, Treasurer and Chief Financial Officer *(1)(2)(3)(4)*

Dale P. Lee

Vice President and Secretary *(1)(2)(3)(4)*

Jane N. O Keeffe

Vice President, Human Resources *(1)*

Robert L. Wells

Vice President, Information Technology, Assistant Secretary and Assistant Treasurer *(1)(3)(4)*

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Chief Operating Officer/Executive Vice President

Carilion Clinic

Director: *(1)(2)*

Abney S. Boxley, III

President and Chief Executive Officer

Boxley Materials Company

Director: *(1)(2)*

Frank T. Ellett

President

Virginia Truck Center, Inc.

Director: [1][2]

Maryellen F. Goodlatte

Attorney and Principal

Glenn Feldmann Darby & Goodlatte

Director: [1][2]

J. Allen Layman

Private Investor

Director: [1][2]

George W. Logan

Chairman of the Board

Valley Financial Corporation

Principal

Pine Street Partners

Faculty

University of Virginia Darden Graduate School of Business

Director: [1]

S. Frank Smith

Vice President Eastern Sales Market Analysis & Research

Alpha Coal Sales Company, LLC

Director: [1][2]

Raymond D. Smoot, Jr.

Chief Operating Officer and Secretary-Treasurer

Virginia Tech Foundation, Inc.

Director: [1]

John B. Williamson, III

Chairman of the Board, President and Chief Executive Officer

Director: [1][2][3][4]

SUBSIDIARY BOARDS OF DIRECTORS:

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Vice President and Chief Operating Officer

Roanoke Gas Company

Director: [3][4]

Howard T. Lyon

Vice President, Treasurer and Controller

RGC Resources, Inc.

Director: [3][4]

Dale P. Lee

Vice President and Secretary

RGC Resources, Inc.

Director: [3][4]

Robert L. Wells

Vice President, Information Technology, Assistant Secretary and Assistant Treasurer

RGC Resources, Inc.

Director: [3][4]

(1) *RGC Resources, Inc.*
(2) *Roanoke Gas Company*
(3) *Diversified Energy Company*
(4) *RGC Ventures of Virginia, Inc.*

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Selected Financial Data

Years Ended September 30,	2008	2007	2006	2005	2004
Operating Revenues	$ 94,636,826	$ 89,901,301	$ 94,590,872	$ 88,600,836	$ 74,152,594
Gross Margin	25,913,612	25,221,776	23,208,272	22,206,395	20,655,455
Operating Income	8,838,026	7,958,279	6,677,500	6,395,564	4,270,554
Net Income - Continuing Operations	4,257,824	3,765,669	2,961,802	2,916,798	1,627,165
Net Income (Loss) - Discontinued Operations	(36,690)	40,540	549,729	590,108	11,306,848
Basic Earnings Per Share- Continuing Operations	$ 1.94	$ 1.74	$ 1.40	$ 1.40	$ 0.80
Basic Earnings Per Share- Discontinued Operations	(0.02)	0.02	0.26	0.29	5.58*
Cash Dividends Declared Per Share	$ 1.25	$ 1.22	$ 1.20	$ 1.18	$ 5.67
Book Value Per Share	19.79	19.38	18.94	18.18	17.73
Average Shares Outstanding	2,201,263	2,162,803	2,120,267	2,079,851	2,027,908
Total Assets	118,127,714	116,332,455	114,662,572	113,563,416	114,972,556
Long-Term Debt (Less Current Portion)	23,000,000	23,000,000	28,000,000	28,000,000	24,000,000
Stockholders Equity	43,723,058	42,365,233	40,494,868	38,157,357	36,621,522
Shares Outstanding at Sept. 30	2,209,471	2,186,143	2,138,595	2,098,935	2,065,408

* Reflects $4.69 gain on sale of assets.

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, the following: (i) failure to earn on a consistent basis an adequate return on invested capital; (ii) ability to retain and attract professional and technical employees; (iii) the potential loss of large-volume industrial customers to alternate fuels, facility closings or production changes; (iv) volatility in the price and availability of natural gas; (v) uncertainty in the demand for natural gas in the Company s service area; (vi) general economic conditions both locally and nationally; (vii) increases in interest rates; (viii) increased customer delinquencies and conservation efforts resulting from high fuel costs, difficult economic conditions and/or colder weather; (ix) variations in winter heating degree-days from the 30-year average on which the Company s billing rates are set; (x) impact of potential climate change legislation regarding limitations on carbon dioxide emissions; (xi) impact of potential increased regulatory oversight and compliance requirements due to financial, environmental, safety and system integrity laws and regulations; (xii) failure to obtain timely rate relief for increasing operating or gas costs from regulatory authorities; (xiii) capital market conditions and the availability of debt and equity financing; (xiv) impact of terrorism; (xv) volatility in actuarially determined benefit costs and plan asset performance; (xvi) effect of natural disasters on production and distribution facilities and the related effect on supply availability and price; and (xvii) changes in accounting regulations and practices, which could change the accounting treatment for certain transactions. All of these factors are difficult to predict and many are beyond the Company s control. Accordingly, while the Company believes its forward-looking statements to be reasonable, there can be no assurance that they will approximate actual experience or that the expectations derived from them will be realized. When used in the Company s documents or news releases, the words, anticipate, believe, intend, plan, estimate, expect, objective, projection, forecast, budget, assume, indicate or similar words or future or conditional verbs such as will, would, should, may are intended to identify forward-looking statements.

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

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Management s Discussion & Analysis

OVERVIEW

Resources is an energy services company primarily engaged in the regulated sale and distribution of natural gas to approximately 56,000 residential, commercial and industrial customers in Roanoke, Virginia and the surrounding areas through its Roanoke Gas Company (Roanoke Gas) subsidiary. The utility operations of Roanoke Gas are regulated by the Virginia State Corporation Commission (SCC or Virginia Commission). Natural gas service is provided at rates and for the terms and conditions set forth by the SCC. Roanoke Gas currently holds the only franchises and/or certificates of public convenience and necessity to distribute natural gas in its Virginia service areas. These franchises are effective through January 1, 2016. While there are no assurances, the Company believes that it will be able to negotiate acceptable franchises when the current agreements expire. Certificates of public convenience and necessity in Virginia are exclusive and are intended to be of perpetual duration.

Resources also provided regulated sale and distribution of natural gas to Bluefield, West Virginia, the Town of Bluefield, Virginia and surrounding areas through its Bluefield Gas Company (Bluefield Gas) subsidiary and the Bluefield division of Roanoke Gas (collectively called Bluefield Operations). Effective as of October 31, 2007, Resources closed on the sale of the stock of Bluefield to ANGD, LLC and Roanoke Gas completed the sale of the assets of its Bluefield division to Appalachian Natural Gas Company, a subsidiary of ANGD, LLC. The Bluefield Operations represented approximately 8% of the natural gas customers of Resources. The corresponding activities of the Bluefield Operations have been classified in discontinued operations as discussed in more detail in the Discontinued Operations section below and footnote 2 of the consolidated financial statements.

Resources also provides certain unregulated natural gas related services through Roanoke Gas Company and information system services through RGC Ventures, Inc. of Virginia, which operates as Application Resources. The unregulated operations represent less than 3% of revenues and margins of Resources.

With the exception of the Discontinued Operations section below, all discussion and analysis excludes the activities of the Bluefield Gas Operations.

Winter weather conditions and volatility in natural gas prices both have a direct influence on the quantity of natural gas sales, and management believes each factor has the potential to significantly impact earnings. A majority of natural gas sales are for space heating during the winter season. Consequently, during warmer than normal (normal refers to the average heating degree-days for a specified period) winters or unevenly cold winters, customers may significantly reduce their consumption of natural gas. Furthermore, significant increases in natural gas commodity prices could also affect customer usage by encouraging conservation or the use of alternative fuels.

Because the SCC authorizes billing rates for the utility operations of Roanoke Gas based on normal winter weather, warmer than normal weather may result in the Company failing to earn its authorized rate of return. The Company has been able to mitigate a portion of the risk associated with warmer than normal winter weather by the inclusion of a weather normalization adjustment (WNA) factor as part of its rate structure, which allows the Company to recover revenues equivalent to the margin that would have been realized at approximately 6% warmer than the 30-year normal. The WNA factor operates based on a weather occurrence band around the most recent 30-year temperature average for the Company s service area, whereby if the number of heating degree-days (an industry measure by which the average daily temperature falls below 65 degrees Fahrenheit) fall within approximately 6% above or below the 30-year average, no adjustment would be made. However, if the number of heating degree-days were more than 6% below the 30-year average, the Company would add a surcharge to firm customer bills (those customers not subject to service interruption) equal to the equivalent margin lost below the approximate 6% level. Likewise, if the number of heating degree-days were more than 6% above the 30-year average, the Company would credit firm customer bills equal to the excess margin realized above the 6% heating degree-day

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level. The measurement period in determining the weather band extends from April through March with any adjustment to be made to customer bills in late spring. The Company recorded approximately $363,000 in additional revenues in fiscal 2008 to reflect the impact of the WNA for the difference in margin realized for weather that was 11% warmer than the 30-year average over the 6% level during the WNA period ended March 31, 2008. In fiscal 2007, the Company recorded approximately $439,000 in additional revenues for the WNA period ended March 31, 2007 for the difference in margin realized for weather that was 12% warmer than the 30-year average over the 6% level.

Management also has concerns regarding the volatility of natural gas prices and the potential for reduced sales in response to increasing prices. Rising natural gas prices, due to increasing demand and limitations to accessible supply, may influence the level of sales due to conservation efforts by customers or by their switching to an alternative fuel, particularly in the industrial market. In addition, increasing prices may increase the level of bad debts due to customers inability to afford the higher prices. During the late spring and early summer of fiscal 2008, natural gas commodity prices nearly doubled the winter price to almost $14 a decatherm before returning to the $7 range at September 30. Although, the prices did not have a significant effect on gas sales due to the normally lower summer sales volumes, these higher prices caused higher-priced gas to be injected into storage. The unit price of gas in storage has increased by 31% over September 30, 2007 s balance. This increase in storage cost will result in higher billing rates to customers during the coming heating season. Supply disruptions, extended periods of cold weather or volatility in the commodities market could also serve to increase the winter gas supply costs.

With regard to the effect of higher natural gas prices on storage gas, the Company has an approved rate structure in place that mitigates the impact of financing costs of inventory related to rising natural gas prices. Under this rate structure, Roanoke Gas accrues revenue to cover the financing costs or carrying costs related to the level of investment in natural gas inventory. 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 inventory costs and lower inventory balances, the Company would recognize less carrying cost revenue as the financing costs would be less. The Company recognized approximately $2,351,000 and $1,955,000 in carrying cost revenues for the years ended September 30, 2008 and 2007.

For the fiscal year ended September 30, 2008, the implementation of a non-gas rate increase, higher inventory carrying cost revenues and reductions in operating expenses more than offset the effect of reduced natural gas sales volumes and increases in maintenance, depreciation and interest expense.

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RESULTS OF OPERATIONS CONTINUING OPERATIONS

Fiscal Year 2008 Compared with Fiscal Year 2007

Delivered Volumes The table below reflects volume activity and heating degree-days.

Year Ended September 30,	2008	2007	Increase/ (Decrease)	Percentage
Regulated Natural Gas (DTH)				
Tariff Sales	6,471,825	6,802,773	(330,948)	-5%
Transportation	2,779,429	2,735,456	43,973	2%
Total	9,251,254	9,538,229	(286,975)	-3%
Heating Degree Days (Unofficial)	3,624	3,735	(111)	-3%

Operating Revenues - The table below reflects operating revenues.

Year Ended September 30,	2008	2007	Increase/ (Decrease)	Percentage
Gas Utilities	$ 93,606,593	$ 89,175,661	$ 4,430,932	5%
Other	1,030,233	725,640	304,593	42%
Total Operating Revenues	$ 94,636,826	$ 89,901,301	$ 4,735,525	5%

Total gas utility operating revenues for the year ended September 30, 2008 (fiscal 2008) increased by 5% over fiscal 2007 even though total delivered volumes declined by 3%. The increase in gas revenues resulted from a steady increase in the commodity price of gas from March through July, with the price climbing from $8.00 to nearly $14.00 a decatherm at its peak. The most significant increases in price occurred during the late spring and early summer when sales volumes are lower; consequently, the effect on revenues was not as significant as it would have been had prices spiked during the heating season. Since July, the commodity price of natural gas has declined to the $7.00 range. For the year, the average per unit cost of natural gas reflected in cost of sales increased by 12%. From a volume perspective, tariff sales, consisting primarily of the more weather sensitive residential and commercial customers, declined by 5% primarily due to a 3% reduction in the number of heating degree-days. Transportation sales increased by 2%, holding steady with last years delivered volumes.

Other revenues increased by 42% primarily due to paving services provided to another local utility under an agreement through the end of December 2008.

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Gross Margin - The table below reflects gross margins.

Year Ended September 30,	2008	2007	Increase/ (Decrease)	Percentage
Gas Utilities	$ 25,323,464	$ 24,833,279	$ 490,185	2%
Other	590,148	388,497	201,651	52%
Total Gross Margin	$ 25,913,612	$ 25,221,776	$ 691,836	3%

Gas utility margins increased by 2% due to the combination of a non-gas rate increase and higher inventory carrying cost revenues even though total delivered volume (tariff and transportation) declined by 3% from last year. In November 2007, Roanoke Gas placed increased non-gas rates into effect subject to refund pending a final order from the Virginia Commission. In April 2008, Roanoke Gas received a final rate order approving approximately $416,000 in additional annual revenues based on normal winter weather. The rate increase provided for both a higher customer base charge, the flat monthly fee billed to each natural gas customer, and a higher volumetric rate. As a result of the rate increase and customer growth, customer base charges accounted for approximately $385,000 of the increase in margin and the increased level of gas in storage provided approximately $395,000 in additional inventory carrying cost revenues. Volumetric sales margins declined by approximately $265,000 as lower delivered volumes more than offset increases in the volumetric billing rates.

Other margins increased by $201,651 primarily due to paving services.

Other Operating Expenses Operations expenses decreased $517,313, or 5%, in fiscal 2008 compared with fiscal 2007 as reductions in employee benefit costs, professional and contractor services and greater level of capitalized overheads more than offset increases in operations labor and bad debt expense. Employee benefit expenses decreased due to a $123,000 reduction in pension costs attributable to higher expected returns on higher plan asset levels and no amortization of an actuarial loss in fiscal 2008 combined with a $47,000 reduction in health insurance premiums. The Company expects both pension costs and medical costs to increase significantly in fiscal 2009. Professional services decreased $181,000 due to less reliance on external assistance related to internal control documentation and testing, lower actuarial expenses, the absence of fees for consent reviews from prior external auditors and reduced levels of computer systems consulting. Increased level of capital activity and production of LNG (liquefied natural gas) reduced operating expenses due to the capitalization of an additional $261,000 of overheads. Bad debt expense increased $76,000 due to the effect of higher natural gas prices and lower recoveries of prior bad debt write-offs. The remaining difference resulted from a variety of other minor expense variances.

Maintenance expenses increased by $50,382, or 4% as a result of higher LNG repairs and computer software and systems maintenance.

General taxes increased $36,77, or 3% in fiscal 2008 compared to fiscal 2007 due to property taxes on a greater level of taxable property.

Depreciation expense increased by $242,249, or 6% due to higher natural gas plant investment from adding new natural gas customers and pipeline renewal projects.

Other Income (Expense) Other income (expense) switched from a net expense position in fiscal 2007 to a net income position in 2008 due to the earnings on the $1,300,000 note from ANGD, LLC received as part of the proceeds on the sale of the Bluefield, Virginia portion of assets.

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Interest Expense Total interest expense for fiscal 2008 increased by $101,638, or 5%, from fiscal 2007, as a result of an increase in average debt outstanding attributable to an increased investment in natural gas storage inventories, utility plant, accounts receivable and under-recovery of gas costs more than offsetting the decline in the average effective interest rate on the Company s line of credit.

Income Taxes Income tax expense from continuing operations increased $345,334, or 15%, from fiscal 2007 corresponding to a 14% increase in pre-tax earnings. The effective tax rate for fiscal 2008 was 37.7% compared to 37.3% in fiscal 2007.

Net Income and Dividends Income from continuing operations for fiscal 2008 was $4,257,824 compared to $3,765,669 for fiscal 2007. Basic and diluted earnings per share from continuing operations were $1.94 and $1.93 in fiscal 2008 compared with $1.74 and $1.73 in fiscal 2007. Dividends declared per share of common stock were $1.25 in fiscal 2008 and $1.22 in fiscal 2007.

DISCONTINUED OPERATIONS

As discussed in footnote 2 of the consolidated financial statements, effective as of October 31, 2007, Resources closed on the sale of the stock of Bluefield Gas to ANGD, LLC, and Roanoke Gas completed the sale of its natural gas distribution assets located in the Town of Bluefield and the County of Tazewell, Virginia (Bluefield division of Roanoke Gas) to Appalachian Natural Gas Company, a subsidiary of ANGD, LLC.

The Bluefield Operations previously absorbed approximately $750,000 annually in costs allocated from Resources and Roanoke Gas that continued after the sale. The Company recovered a portion of these costs through a services agreement with ANGD and through non-gas cost rate filings. The Company also reduced a portion of these costs through staff reductions.

Although the Purchase and Sale Agreement with ANGD for the sale of the capital stock of Bluefield Gas provided for a sales price substantially equal to the book value of Bluefield s net assets on the date of closing, the underlying tax basis that Resources had in the stock was significantly less than its book basis. This lower tax basis resulted in the recording of an income tax expense of approximately $535,000 attributable to the taxable gain for the excess of the book basis of the assets over the tax basis. The tax liability was reflected as part of income tax expense in discontinued operations for fiscal 2007.

ASSET MANAGEMENT

Roanoke Gas uses a third party as an asset manager to manage its pipeline transportation, 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 2010.

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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 and accounts receivable and payment of dividends. To meet these needs, the Company relies on its operating cash flows, line-of-credit agreements, long-term debt and capital raised through the Company s Dividend Reinvestment and Stock Purchase Plan (DRIP).

Cash and cash equivalents decreased by $532,881 in fiscal 2008 compared to $81,824 decrease in fiscal 2007. The following table summarizes the categories of sources and uses of cash:

Year Ended September 30,	**2008**	**2007**
Continuing operations:		
Provided by operating activities	$ 497,778	$ 5,630,055
Used in investing activities	(3,166,506)	(5,991,850)
Provided by financing activities	2,061,120	15,761
Cash provided by discontinued operations	74,727	264,210
Decrease in cash and cash equivalents	$ (532,881)	$ (81,824)

Due to the seasonal nature of the natural gas business, operating cash flows may 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, 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 the increases in natural gas storage levels, rising customer receivable balances and construction activity. In fiscal 2008, cash provided by continuing operating activities decreased by approximately $5,100,000, from $5,600,000 in fiscal 2007 to $500,000 in fiscal 2008, as purchases for gas in storage increased due to the sharp rise in the commodity price of natural gas during the late spring and early summer. The higher prices resulted in an increase in gas in storage balances of approximately $7,000,000 over the same period last year. Increases in net income and accounts payable balances associated with the higher gas costs partially offset the decrease in operating cash flows.

Investing activities are generally composed of expenditures under the Company s construction program, which involves a combination of replacing aging bare steel and cast iron pipe with new plastic or coated steel pipe and expansion of its natural gas system to meet the demands of customer growth. Cash flows used in investing activities declined by approximately $2,800,000 due to cash proceeds received from the sale of Bluefield Operations. Total capital expenditures from continuing operations were approximately $6,500,000 and $6,000,000 for the years ended September 30, 2008 and 2007, respectively. Although new construction related to expanding natural gas service has declined due to the current slow down in real estate development and economic environment, the Company plans to continue its focus on pipeline renewals and expects such expenditures to continue for the next several years. Operating cash flow provided by depreciation contributed approximately $4,500,000 in support of fiscal 2008 capital expenditures, or approximately 69% of the total investment, compared to approximately $4,300,000, or 72% of the total investment in fiscal 2007. The Company also relies on its line-of-credit agreements, other operating cash flows and long-term debt financing to provide the underlying funding its capital expenditures.

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Resources and Roanoke Gas closed on the sale of the Bluefield Operations effective as of October 31, 2007. The Company received approximately $3,800,000 after retirement of Bluefield s outstanding debt and a subordinated note of $1,300,000. The Company used the net proceeds to infuse capital into Roanoke Gas to help fund its construction and pipeline renewal programs. Resources also invested $500,000 of the proceeds from the sale of Bluefield Gas stock in a short-term investment.

Financing activities generally consist of long-term and short-term borrowings and repayments, issuance of stock and the payment of dividends. Cash flow from continuing financing activities increased by approximately $2,000,000 over fiscal 2007 due to increased borrowing under the Company s line-of-credit agreement. As discussed above, the Company uses its line-of-credit arrangements to fund seasonal working capital needs as well as provide temporary financing for capital projects. Total cash provided by the line-of-credit for Roanoke Gas increased by $9,150,000. $5,000,000 of the increase was used to retire Roanoke Gas first mortgage note that matured on July 1, 2008. The remainder of the increase was used to support the higher investment in storage gas inventories and capital expenditure financing.

On June 30, 2008, the Company executed a new line-of-credit agreement for Roanoke Gas. The new agreement increases the total available line-of-credit for the balance of the term of the original note dated March 28, 2008. Significantly higher natural gas prices at the time prompted the need for additional working capital to fund natural gas purchases and accounts receivable. The Company is currently evaluating its funding needs under the line-of-credit agreement for Roanoke Gas and may reduce the available balances in light of the lower commodity price of gas. The line-of-credit agreements expire March 31, 2009, unless extended. The Company anticipates being able to extend or replace the line-of-credit agreements upon expiration. The Company s total available limits under the remaining term of the line-of-credit agreements are as follows:

Beginning	**Available Limit**
September 30, 2008	$ 27,000,000
November 16, 2008	29,000,000
February 16, 2009	16,000,000

The remainder of the financing cash flows was associated with approximately $641,000 of proceeds related to stock issuances under the DRIP and approximately $2,700,000 in dividends paid.

On October 31, 2008, the Roanoke Gas executed a $5,000,000 variable-rate promissory note due December 1, 2015 to replace the first mortgage note that matured on July 1, 2008. The interest rate on the note is LIBOR plus 125 basis points. Roanoke Gas also entered into an interest-rate swap agreement for the same term as the note to effectively convert the variable-rate note into a fixed-rate debt with an interest rate of 5.79%.

At September 30, 2008, the Company s consolidated long-term capitalization was 65% equity and 35% debt, compared to 60% equity and 40% debt at September 30, 2007. If the $5,000,000 variable-rate note had been in place at September 30, 2008, the Company s long-term capitalization would have been 61% equity and 39% debt.

REGULATORY AFFAIRS

On November 1, 2007, Roanoke Gas Company placed into effect new base rates to provide for approximately $700,000 in additional annual revenues, subject to refund. The Company received the final order from the SCC on May 22, 2008 approving rates, which provided for approximately $416,000 in additional annual revenues. In June 2008, the Company completed its refund of rates billed in excess of the amount authorized by the final order, including interest on the excess amount.

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On September 16, 2008, the Company filed a request for an expedited rate increase with the SCC. The request was for an increase of approximately $1,198,000 in annual non-gas revenues. Under an expedited rate request, the Company is able to place the increased rates into effect for service rendered on and after November 1, 2008, subject to refund pending a final order by the SCC. The hearing on the request for rate increase is scheduled for late March 2009, with a final order expected some time after that date.

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 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. The Company considers the following accounting policies and estimates to be critical.

Regulatory accounting The Company s regulated operations follow the accounting and reporting requirements of Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* (SFAS No. 71). The economic effects of regulation can result in a regulated company deferring costs that have been or are expected to be recovered from customers in a period different from the period in which the costs would be charged to expense by an unregulated enterprise. When this occurs, costs are deferred as assets in the consolidated balance sheet (regulatory assets) and recorded as expenses when such amounts are reflected in rates. Additionally, regulators can impose liabilities upon a regulated company for amounts previously collected from customers and for current collection in rates of costs that are expected to be incurred in the future (regulatory liabilities).

If, for any reason, the Company ceases to meet the criteria for application of regulatory accounting treatment for all or part of its operations, the Company would remove the regulatory assets or liabilities from the balance sheet related to those portions no longer meeting the criteria and include them in the consolidated statement of income and comprehensive income for the period in which the discontinuance occurred.

Revenue recognition Regulated utility sales and transportation revenues are based upon rates approved by the SCC. The non-gas cost component of rates may not be changed without a formal rate increase application and corresponding authorization by the SCC; however, the gas cost component of rates may be adjusted periodically through the PGA mechanism with approval from the SCC.

The Company bills its regulated natural gas customers on a monthly cycle. The billing cycle periods for most customers do not coincide with the accounting periods used for financial reporting. The Company accrues estimated revenue for natural gas delivered to customers not yet billed during the accounting period. Determination of unbilled revenue relies on the use of estimates, weather during the period and current and historical data. The financial statements included unbilled revenue of $1,475,406 and $1,287,362 as of September 30, 2008 and 2007.

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Allowance for Doubtful Accounts The Company evaluates the collectibility of its accounts receivable balances based upon a variety of factors including loss history, level of delinquent account balances and general economic climate.

Pension and Postretirement Benefits The Company offers a defined benefit pension plan (pension plan) and a postretirement medical and life insurance plan (postretirement plan) to eligible employees. The expenses and liabilities associated with these plans, as disclosed in footnote 7 to the consolidated financial statements, are based on numerous assumptions and factors, including provisions of the plans, employee demographics, contributions made to the plan, return on plan assets and various actuarial calculations, assumptions and accounting requirements. In regard to the pension plan, specific factors include assumptions regarding the discount rate used in determining future benefit obligations, expected long-term rate of return on plan assets, compensation increases and life expectancies. Similarly, the postretirement medical plan also requires the estimation of many of the same factors as the pension plan in addition to assumptions regarding the rate of medical inflation and Medicare availability. Actual results may differ materially from the results expected from the actuarial assumptions due to changing economic conditions, volatility in interest rates and changes in life expectancy. Such differences may result in a material impact on the amount of expense recorded in future periods or the value of the obligations on the balance sheet.

In selecting the discount rate to be used in determining the benefit liability, the Company considered the rates of return on high-quality fixed-income investments that corresponded to the benefit streams expected under both the pension plan and postretirement plan. The Company also used an asset/liability model to evaluate the probability of meeting the returns on its targeted investment allocation model. The investment policy as of the measurement date in June reflected a targeted allocation of 60% equity and 40% fixed income for an assumed long-term rate of return of 7.5% on the pension plan and a targeted allocation of 50% equity and 50% fixed income for an assumed long-term rate of return of 5.22% (net of income taxes) for the postretirement plan. Based on the assumptions described above and in footnote 7, pension expense is expected to increase from approximately $378,000 in fiscal 2008 to $459,000 in fiscal 2009 and postretirement expense is expected to go from approximately $554,000 in fiscal 2008 to $540,000 in fiscal 2009. The Company expects to contribute approximately $600,000 each to its pension and postretirement plans. However, funding requirements under the Pension Protection Act of 2006 could require the Company to increase its projected contribution levels if the plans funded status is significantly deteriorated by the current economic environment.

The following schedule reflects the sensitivity of pension costs to changes in certain actuarial assumptions, assuming that the other components of the calculation remain constant.

Actuarial Assumption	Change in Assumption	Impact on 2008 Pension Cost	Impact on Projected Benefit Obligation
Discount rate	-0.25%	$ 66,000	$ 568,000
Rate of return on plan assets	-0.25%	29,000	N/A
Rate of increase in compensation	0.25%	42,000	218,000

The following schedule reflects the sensitivity of postretirement benefit costs from changes in certain actuarial assumptions, while the other components of the calculation remain constant.

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Actuarial Assumption	Change in Assumption	Impact on 2008 Postretirement Benefit Cost	Impact on Accumulated Benefit Obligation
Discount rate	-0.25%	$ 11,000	$ 260,000
Rate of return on plan assets	-0.25%	13,000	N/A
Health care cost trend rate	0.25%	28,000	235,000

Since June 30, 2008, the measurement date used for determining several of the actuarial assumptions as well as determining the market value of the plan assets of both the pension plan and postretirement medical plan, the economic crisis resulting from issues in the credit markets have significantly reduced the value of the plan assets. Although the determination of fiscal 2009 expense components has already been determined, the recent decline in asset values, if not reversed, has the potential to significantly affect funded status, future funding requirements and expense recognition in future financial statements.

Derivatives The Company may hedge certain risks incurred in its operation through the use of derivative instruments. The Company applies the requirements of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which requires the recognition of derivative instruments as assets or liabilities in the Company s balance sheet at fair value. In most instances, fair value is based upon quoted futures prices for natural gas commodities and interest rate futures for interest rate swaps. Changes in the commodity and futures markets will impact the estimates of fair value in the future. Furthermore, the actual market value at the point of realization of the derivative may be significantly different from the values used in determining fair value in prior financial statements.

MARKET RISK

The Company is exposed to market risks through its natural gas operations associated with commodity prices. The Company s risk management policy, as authorized by the Company s Board of Directors, allows management to enter into both physical and financial transactions for the purpose of managing commodity risk of its business operations. The policy also specifies that the combination of all commodity hedging contracts for any 12-month period shall not exceed a total hedged volume of 90% of projected volumes. Finally, the policy specifically prohibits the utilization of derivatives for the purposes of speculation.

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

As of September 30, 2008, the Company had collar agreements outstanding for the purpose of hedging the price of natural gas during the winter period for 370,000 decatherms. Any cost incurred or benefit received from the derivative or other hedging arrangements would be expected to be recoverable or refunded through the regulated natural gas purchased gas adjustment (PGA) mechanism. 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 will be passed through to customers when realized.

The Company is also exposed to market risk related to changes in interest rates associated with its borrowing activities. As of September 30, 2008, the Company had $13,960,000 outstanding under its lines-of-credit. Based upon outstanding borrowings at September 30, 2008, a 100 basis point increase in market interest rates applicable to the Company s variable rate debt would have resulted in an increase in annual interest expense of approximately $139,000.

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OTHER RISKS

The Company is exposed to certain risks other than commodity and interest rates. Such other events, situations or conditions have or potentially could have an impact on the future results of operations of the Company. For most of the items described below, the regulated natural gas operations in Virginia have a means to recover increased costs through formal rate application filings, as well as the ability to automatically pass along increases in natural gas cost. However, rate applications are generally filed based upon historical expenses, which generally results in the Company lagging in the recovery of rapidly increasing operating expenses. Moreover, there can be no guarantee that the SCC will allow recovery for all such increased costs when rate applications are filed.

Regulatory and Governmental Actions As discussed above, Virginia has a means to allow the regulated operations of the Company to recover increased costs and earn a reasonable rate of return on equity. The SCC is the state agency responsible for regulating the operations of Roanoke Gas and approves the rates charged to its customers. If the SCC were to impose limitations to delay or prohibit the Company from placing rates into effect to timely recover costs and earn a rate of return, the earnings of the Company could be impacted. Furthermore, legislation at the state or federal level could impose undue costs and burdens on the Company from both a cost and operational perspective.

Energy Prices Energy costs represent the single largest expense of the Company with the cost of natural gas representing approximately 80% and 79% for fiscal 2008 and 2007 of the total operating expenses of the Company s natural gas utility operations. Increases or decreases in natural gas costs are passed through to customers under the present PGA mechanism. As discussed above, increases in the commodity price of natural gas may cause existing customers to conserve or switch to alternate sources of energy. High natural gas prices may also discourage new home developers and new potential customers from selecting natural gas as their energy choice. Furthermore, during periods when natural gas prices are significantly higher than historical levels, customers may have much greater difficulty paying their natural gas bills, resulting in higher bad-debt expense and lower earnings. Roanoke Gas Company s rate structure provides a level of protection against the impact that rising energy prices may have on bad debts by providing for recovery of these costs. However, the rate structure will not protect the Company from increases in the rate of bad debts.

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Credit and Customer Gas costs represent a major portion of the total customer bill. The Company has worked diligently at minimizing bad debts and bad-debt write offs. However, management anticipates that future significant increases or spikes in natural gas prices could result in an increased rate of delinquencies as customers face higher natural gas bills as well as other higher energy costs. In addition, the SCC has specific notice requirements with which the Company must comply before disconnecting natural gas service for customer nonpayment. The Company has mitigated some of the risk through increased deposit requirements based upon higher energy prices, as well as obtaining credit insurance coverage on certain of the Company s larger volume industrial customers. Furthermore, the Company s approved rate structure provides a level of protection against the impact that rising energy prices may have on bad debts. Nevertheless, the Company has no such protection if the percentage of bad debts to revenues increases above recent historical levels.

Weather The nature of the Company s business is highly dependent upon weather specifically, winter weather. Cold weather increases energy consumption by customers and therefore increases revenues and margins. Conversely, warm weather reduces energy consumption and ultimately revenues and margins. Since 2003, Roanoke Gas Company s rate structure has included a weather normalization adjustment factor as discussed above. The Company should be at risk for no more than a 6% swing in heating degree-days above or below average.

Credit and Capital Availability The capital intensive and seasonal nature of the utility operations requires the access to sufficient levels of debt and equity capital. Recent events in the credit and financial markets have impacted the cost and availability of short-term and long-term credit funding. The Company was able to complete the financing of a $5 million unsecured promissory note on October 31; however, continued uncertainty in financial markets could negatively affect the availability and price of the Company s line-of-credit agreements. Although the Company believes that it will be able to renew these agreements, it is uncertain whether the renewal will be under the same or less favorable terms. The failure to obtain funding when needed, or obtain funding only on unfavorable terms, could have a significant negative impact to the Company.

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Capitalization Statistics

Years Ended September 30,	2008	2007	2006	2005	2004
COMMON STOCK:					
Shares Issued	2,209,471	2,186,143	2,138,595	2,098,935	2,065,408
Continuing Operations:					
Basic Earnings Per Share	$ 1.94	$ 1.74	$ 1.40	$ 1.40	$ 0.80
Diluted Earnings Per Share	$ 1.93	$ 1.73	$ 1.39	$ 1.39	$ 0.80
Discontinued Operations:					
Basic Earnings Per Share	$ (0.02)	$ 0.02	$ 0.26	$ 0.29	$ 5.58*
Diluted Earnings Per Share	$ (0.02)	$ 0.02	$ 0.26	$ 0.29	$ 5.53
Dividends Paid Per Share (Cash)	$ 1.25	$ 1.22	$ 1.20	$ 1.18	$ 5.67
Dividends Paid Out Ratio	65.1%	69.3%	72.3%	69.8%	88.9%
CAPITALIZATION RATIOS:					
Long-Term Debt, Including Current Maturities	34.5	39.8	40.9	42.3	39.6
Common Stock And Surplus	65.5	60.2	59.1	57.7	60.4
Total	100.0	100.0	100.0	100.0	100.0
Long-Term Debt, Including Current Maturities	$ 23,000,000	$ 28,000,000	$ 28,000,000	$ 28,000,000	$ 24,019,987
Common Stock And Surplus	43,723,058	42,365,233	40,494,868	38,157,357	36,621,522
Total Capitalization Plus Current Maturities	$ 66,723,058	$ 70,365,233	68,494,868	66,157,357	60,641,509

* Reflects $4.69 gain on sale of assets.

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Market Price and Dividend Information

RGC Resources common stock is listed on the Nasdaq National Market under the trading symbol RGCO. Payment of dividends is within the discretion of the Board of Directors and will depend on, among other factors, earnings, capital requirements, and the operating and financial condition of the Company. The Company s long-term indebtedness contains restrictions on dividends based on cumulative net earnings and dividends previously paid.

Fiscal Year Ended September 30,	Range of Bid Prices High	Range of Bid Prices Low	Cash Dividends Declared
2008			
First Quarter	$ 33.35	$ 26.02	$ 0.3125
Second Quarter	31.43	27.25	0.3125
Third Quarter	29.25	27.13	0.3125
Fourth Quarter	32.50	26.68	0.3125
2007			
First Quarter	$ 27.80	$ 24.77	$ 0.305
Second Quarter	28.70	24.84	0.305
Third Quarter	29.01	27.01	0.305
Fourth Quarter	28.70	25.88	0.305

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Summary of Gas Sales and Statistics

Years Ended September 30,	2008	2007	2006	2005	2004
REVENUES:					
Residential Sales	$ 52,927,761	$ 50,791,195	$ 52,274,204	$ 49,332,645	$ 42,826,979
Commercial Sales	36,507,326	34,566,385	36,159,320	33,059,542	27,154,959
Interruptible Sales	1,509,193	1,379,870	3,054,240	3,029,697	1,234,144
Transportation Gas Sales	2,428,656	2,254,594	2,067,929	2,110,002	2,120,506
Backup Services	3,600	3,600	3,600	62,756	51,452
Late Payment Charges	55,410	55,438	70,191	55,109	71,065
Miscellaneous Gas Utility Revenue	174,647	124,579	116,924	102,918	92,433
Other	1,030,233	725,640	844,464	848,167	601,056
Total	$ 94,636,826	$ 89,901,301	$ 94,590,872	$ 88,600,836	$ 74,152,594
NET INCOME					
Continuing Operations	$ 4,257,824	$ 3,765,669	$ 2,961,802	$ 2,916,798	$ 1,627,165
Discontinued Operations	(36,690)	40,540	549,729	590,108	11,306,848
Net Income	$ 4,221,134	$ 3,806,209	$ 3,511,531	$ 3,506,906	$ 12,934,013
DTH DELIVERED:					
Residential	3,557,249	3,778,194	3,588,364	3,987,368	4,281,320
Commercial	2,785,701	2,886,403	2,793,988	2,859,471	2,937,469
Interruptible	128,875	138,176	278,535	321,860	153,714
Transportation Gas	2,779,429	2,735,456	2,853,500	3,202,923	3,391,620
Backup Service	0	0	0	5,531	5,530
Total	9,251,254	9,538,229	9,514,387	10,377,153	10,769,653
HEATING DEGREE DAYS	3,624	3,735	3,714	3,783	3,917
NUMBER OF CUSTOMERS:					
Natural Gas					
Residential	50,630	50,371	49,649	49,178	48,215
Commercial	5,026	5,017	4,948	4,939	4,903
Interruptible and Interruptible Transportation Service	33	32	32	36	36
Total	55,689	55,420	54,629	54,153	53,154
GAS ACCOUNT (DTH):					
Natural Gas Available	9,528,890	9,744,431	9,703,011	10,546,259	11,061,144
Natural Gas Deliveries	9,251,254	9,538,229	9,514,387	10,377,153	10,769,653
Storage - LNG	122,874	65,279	98,936	89,896	117,378
Company Use And Miscellaneous	45,180	28,862	36,321	47,568	52,440
System Loss	109,582	112,061	53,367	31,642	121,673
Total Gas Available	9,528,890	9,744,431	9,703,011	10,546,259	11,061,144
TOTAL ASSETS	$ 118,127,714	$ 116,332,455	$ 114,662,572	$ 113,563,416	$ 114,972,556
LONG-TERM OBLIGATIONS	$ 23,000,000	$ 23,000,000	28,000,000	28,000,000	24,000,000

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RGC Resources, Inc. and Subsidiaries

Consolidated Financial Statements

for the Years Ended September 30, 2008

and 2007, and Report of Independent

Registered Public Accounting Firm

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RGC RESOURCES, INC. AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

RGC Resources, Inc.

Roanoke, Virginia

We have audited the accompanying consolidated balance sheets of RGC Resources, Inc. and Subsidiaries (the Company) as of September 30, 2008 and 2007, and the related consolidated statements of income and comprehensive income, stockholders equity, and cash flows for the years then ended. The Company s management is responsible for these financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of RGC Resources, Inc. and Subsidiaries as of September 30, 2008 and 2007, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

CERTIFIED PUBLIC ACCOUNTANTS

319 McClanahan Street, S.W.

Roanoke, Virginia

November 7, 2008

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RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF SEPTEMBER 30, 2008 AND 2007

	2008	2007
ASSETS		