

***RGC Resources, Inc.
and Subsidiaries***

*Consolidated Financial Statements
for the Years Ended September 30, 2007, 2006,
and 2005, 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 sheet of RGC Resources, Inc. and Subsidiaries (“the Company”) as of September 30, 2007 and 2006, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The financial statements of RGC Resources, Inc. and Subsidiaries for the year ended September 30, 2005, before the adjustment to reflect the Bluefield, Virginia and West Virginia operations and the energy marketing division as discontinued operations as described in Note 2, were audited by other auditors whose report, dated December 15, 2005, expressed an unqualified opinion on those statements.

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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, 2007 and 2006, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

On February 16, 2007 the Company entered into agreements to sell its Bluefield, Virginia and West Virginia operations, and on July 10, 2006, the Company sold certain of its assets related to the energy marketing business. We have audited the adjustments to the 2005 financial statements to retroactively reflect the Bluefield, Virginia and West Virginia operations and the energy marketing business as Discontinued Operations as more fully described in Note 2. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2005 financial statements of the Company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2005 financial statements taken as a whole.

As discussed in Notes 1 and 7, the Company changed its method of accounting for its defined benefit pension plan and its post retirement benefit plan to adopt Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)*.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

319 McClanahan Street, S.W.
Roanoke, Virginia
November 14, 2007

— Providing Professional Business Advisory & Consulting Services —

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2007 AND 2006

	2007	2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,408,317	\$ 1,490,141
Accounts receivable, less allowance for doubtful accounts of \$46,710 in 2007 and \$26,584 in 2006	4,447,928	4,558,458
Materials and supplies	515,722	553,773
Gas in storage	19,156,833	19,932,064
Assets available for sale	12,825,344	13,726,791
Prepaid income taxes	1,649,788	879,957
Deferred income taxes	1,001,162	2,654,548
Other	<u>455,445</u>	<u>392,564</u>
 Total current assets	 <u>41,460,539</u>	 <u>44,188,296</u>
UTILITY PROPERTY:		
In service	108,348,844	102,822,594
Accumulated depreciation and amortization	<u>(36,424,831)</u>	<u>(34,447,514)</u>
 In service—net	 <u>71,924,013</u>	 <u>68,375,080</u>
 Construction work in progress	 <u>663,256</u>	 <u>1,702,416</u>
 Utility plant—net	 <u>72,587,269</u>	 <u>70,077,496</u>
 Other assets	 <u>2,284,647</u>	 <u>396,780</u>
 TOTAL ASSETS	 <u>\$ 116,332,455</u>	 <u>\$ 114,662,572</u>

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RG C RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2007 AND 2006

	2007	2006
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 5,000,000	\$ -
Borrowings under lines of credit	4,808,000	3,353,000
Dividends payable	667,245	643,067
Accounts payable	6,457,602	8,328,365
Customer credit balances	4,308,415	4,027,668
Customer deposits	1,439,765	1,245,508
Accrued expenses	2,106,222	3,484,476
Liabilities of assets available for sale	7,558,605	8,252,463
Over-recovery of gas costs	567,295	2,112,256
Fair value of marked-to-market transactions	86,025	1,486,699
	<u>32,999,174</u>	<u>32,933,502</u>
Total current liabilities		
LONG-TERM DEBT, excluding current maturities	<u>23,000,000</u>	<u>28,000,000</u>
DEFERRED CREDITS AND OTHER LIABILITIES:		
Asset retirement obligations	2,499,345	2,404,839
Regulatory cost of retirement obligations	6,043,088	5,319,198
Benefit plan liabilities	3,855,292	-
Deferred income taxes	5,442,563	5,351,746
Deferred investment tax credits	127,760	158,419
	<u>17,968,048</u>	<u>13,234,202</u>
Total deferred credits and other liabilities		
COMMITMENTS AND CONTINGENCIES (Notes 10 and 11)		
CAPITALIZATION:		
Stockholders' equity:		
Common stock, \$5 par value; authorized 10,000,000 shares; issued and outstanding 2,186,143 and 2,138,595 shares in 2007 and 2006, respectively	\$ 10,930,715	\$ 10,692,975
Preferred stock, no par; authorized 5,000,000 shares; no shares issued or outstanding in 2007 and 2006	-	-
Capital in excess of par value	15,466,756	14,521,812
Retained earnings	16,443,017	15,282,909
Accumulated other comprehensive loss	(475,255)	(2,828)
	<u>42,365,233</u>	<u>40,494,868</u>
Total stockholders' equity		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u><u>\$ 116,332,455</u></u>	<u><u>\$ 114,662,572</u></u>

(Concluded)

See notes to consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME YEARS ENDED SEPTEMBER 30, 2007, 2006, AND 2005

	2007	2006	2005
OPERATING REVENUES:			
Gas utilities	\$ 89,175,661	\$ 93,746,408	\$ 87,752,669
Other	<u>725,640</u>	<u>844,464</u>	<u>848,167</u>
Total operating revenues	<u>89,901,301</u>	<u>94,590,872</u>	<u>88,600,836</u>
COST OF SALES:			
Gas utilities	64,342,382	70,885,690	66,036,050
Other	<u>337,143</u>	<u>496,910</u>	<u>358,391</u>
Total cost of sales	<u>64,679,525</u>	<u>71,382,600</u>	<u>66,394,441</u>
GROSS MARGIN	<u>25,221,776</u>	<u>23,208,272</u>	<u>22,206,395</u>
OTHER OPERATING EXPENSES:			
Operations	10,624,555	10,277,021	9,781,845
Maintenance	1,419,830	1,286,732	1,321,621
General taxes	1,130,522	1,114,166	1,051,041
Depreciation and amortization	<u>4,088,590</u>	<u>3,852,853</u>	<u>3,656,324</u>
Total other operating expenses	<u>17,263,497</u>	<u>16,530,772</u>	<u>15,810,831</u>
OPERATING INCOME	7,958,279	6,677,500	6,395,564
OTHER EXPENSES—Net	24,758	12,630	60,747
INTEREST EXPENSE	<u>1,931,444</u>	<u>2,000,653</u>	<u>1,700,174</u>
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	6,002,077	4,664,217	4,634,643
INCOME TAX EXPENSE FROM CONTINUING OPERATIONS	<u>2,236,408</u>	<u>1,702,415</u>	<u>1,717,845</u>
INCOME FROM CONTINUING OPERATIONS	<u>3,765,669</u>	<u>2,961,802</u>	<u>2,916,798</u>
DISCONTINUED OPERATIONS:			
Income from discontinued operations—net of income taxes of \$835,836, \$382,558 and \$395,482 in 2007, 2006, and 2005, respectively	<u>40,540</u>	<u>549,729</u>	<u>590,108</u>
NET INCOME	3,806,209	3,511,531	3,506,906
OTHER COMPREHENSIVE INCOME (LOSS)— NET OF TAX	<u>(50,542)</u>	<u>377,643</u>	<u>(334,961)</u>
COMPREHENSIVE INCOME	<u>\$ 3,755,667</u>	<u>\$ 3,889,174</u>	<u>\$ 3,171,945</u>

(Continued)

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME YEARS ENDED SEPTEMBER 30, 2007, 2006, AND 2005

	2007	2006	2005
BASIC EARNINGS PER COMMON SHARE:			
Income from continuing operations	\$ 1.74	\$ 1.40	\$ 1.40
Discontinued operations	<u>0.02</u>	<u>0.26</u>	<u>0.29</u>
Net income	<u>\$ 1.76</u>	<u>\$ 1.66</u>	<u>\$ 1.69</u>
DILUTED EARNINGS PER COMMON SHARE:			
Income from continuing operations	\$ 1.73	\$ 1.39	\$ 1.39
Discontinued operations	<u>0.02</u>	<u>0.26</u>	<u>0.29</u>
Net income	<u>\$ 1.75</u>	<u>\$ 1.65</u>	<u>\$ 1.68</u>
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:			
Basic	2,162,803	2,120,267	2,079,851
Diluted	2,173,258	2,130,720	2,093,115
			(Concluded)

See notes to consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY YEARS ENDED SEPTEMBER 30, 2007, 2006 AND 2005

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
BALANCE—September 30, 2004	\$ 10,327,040	\$ 13,064,566	\$ 13,275,426	\$ (45,510)	\$ 36,621,522
Net income	-	-	3,506,906	-	3,506,906
Gain on hedging activities— net of tax	-	-	-	53,951	53,951
Minimum pension liability— net of tax	-	-	-	(388,912)	(388,912)
Cash dividends declared (\$1.18 per share)	-	-	(2,459,527)	-	(2,459,527)
Issuance of common stock (33,527 shares)	<u>167,635</u>	<u>655,782</u>	<u>-</u>	<u>-</u>	<u>823,417</u>
BALANCE—September 30, 2005	10,494,675	13,720,348	14,322,805	(380,471)	38,157,357
Net income	-	-	3,511,531	-	3,511,531
Loss on hedging activities— net of tax	-	-	-	(11,269)	(11,269)
Minimum pension liability— net of tax	-	-	-	388,912	388,912
Cash dividends declared (\$1.20 per share)	-	-	(2,551,427)	-	(2,551,427)
Issuance of common stock (39,660 shares)	<u>198,300</u>	<u>801,464</u>	<u>-</u>	<u>-</u>	<u>999,764</u>
BALANCE—September 30, 2006	10,692,975	14,521,812	15,282,909	(2,828)	40,494,868
Net income	-	-	3,806,209	-	3,806,209
Loss on hedging activities— net of tax	-	-	-	(50,542)	(50,542)
Adoption of SFAS No. 158	-	-	-	(421,885)	(421,885)
Cash dividends declared (\$1.22 per share)	-	-	(2,646,101)	-	(2,646,101)
Issuance of common stock (47,548 shares)	<u>237,740</u>	<u>944,944</u>	<u>-</u>	<u>-</u>	<u>1,182,684</u>
BALANCE—September 30, 2007	<u>\$ 10,930,715</u>	<u>\$ 15,466,756</u>	<u>\$ 16,443,017</u>	<u>\$ (475,255)</u>	<u>\$ 42,365,233</u>

See notes to consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED SEPTEMBER 30, 2007, 2006 AND 2005

	2007	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income from continuing operations	\$ 3,765,669	\$ 2,961,802	\$ 2,916,798
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	4,301,102	4,064,704	3,882,593
Cost of removal of utility plant—net	(252,931)	(243,015)	(213,924)
Loss on disposal of property	-	-	33,590
Gain on sale of short-term investments	-	-	(8,540)
Change in over/under recovery of gas costs	(3,027,101)	5,322,010	(3,896,107)
Deferred taxes and investment tax credits	2,003,043	55,201	(154,638)
Other noncash items—net	18,201	(144,761)	96,406
Changes in assets and liabilities which provided (used) cash:			
Accounts receivable and customer deposits—net	304,787	2,399,290	(948,205)
Inventories, gas in storage and prepaid gas	813,282	225,010	(4,984,889)
Other current assets	(832,712)	64,213	1,081,587
Accounts payable, customer credit balances and accrued expenses	(1,463,285)	(5,454,627)	7,052,308
Total adjustments	1,864,386	6,288,025	1,940,181
Net cash provided by continuing operating activities	5,630,055	9,249,827	4,856,979
Net cash provided by discontinued operations	991,317	1,046,633	656,916
Net cash provided by operating activities	6,621,372	10,296,460	5,513,895
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to utility plant and nonutility property	(6,004,190)	(7,175,409)	(6,685,229)
Proceeds from disposal of utility and nonutility property	12,340	3,416	83,371
Proceeds from sale of short-term investments	-	-	5,000,000
Net cash used in continuing investing activities	(5,991,850)	(7,171,993)	(1,601,858)
Net cash used in discontinued investing activities	(204,107)	(406,716)	(3,178)
Net cash used in investing activities	(6,195,957)	(7,578,709)	(1,605,036)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of long-term debt	-	15,000,000	-
Retirement of long-term debt and capital leases	-	(11,000,000)	(19,987)
Net repayments under line-of-credit agreements	1,455,000	(4,672,000)	(1,049,000)
Proceeds from issuance of common stock	1,182,684	999,764	823,417
Cash dividends paid	(2,621,923)	(2,527,892)	(11,743,988)
Net cash provided by (used in) continuing financing activities	15,761	(2,200,128)	(11,989,558)
Net cash used in discontinued financing activities	(523,000)	(377,000)	(31,000)
Net cash used in financing activities	(507,239)	(2,577,128)	(12,020,558)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(81,824)	140,623	(8,111,699)
CASH AND CASH EQUIVALENTS—Beginning of year	1,490,141	1,349,518	9,461,217
CASH AND CASH EQUIVALENTS—End of year	\$ 1,408,317	\$ 1,490,141	\$ 1,349,518

(Continued)

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED SEPTEMBER 30, 2007, 2006 AND 2005

	2007	2006	2005
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:			
Cash paid during the year for:			
Interest	<u>\$ 2,335,713</u>	<u>\$ 2,377,906</u>	<u>\$ 2,131,430</u>
Income taxes—net of refunds	<u>\$ 1,952,794</u>	<u>\$ 1,888,858</u>	<u>\$ 912,844</u>
Non-cash transactions:			
In 2007, 2006 and 2005, the Company entered into derivative arrangements for the purpose of hedging the cost of gas and in 2005 entered into an interest rate swap to hedge interest expense. In accordance with hedge accounting requirements, the underlying derivatives were marked to market with the corresponding non-cash impacts to the consolidated balance sheets:			
Fair value of marked-to-market transactions	\$ (1,400,674)	\$ 1,500,305	\$ (86,962)
Over recovery of gas costs	1,482,140	(1,482,140)	-
Deferred tax liability	32,655	6,896	(33,011)
In September 2007, the Company adopted FASB No. 158 (as discussed in Note 7) which resulted in the establishment of a benefit liability attributable to the Company's underfunded positions under its pension and post-retirement medical plans as well as a regulatory asset related to the portion pertaining to the regulated operations. Prior to the adoption of SFAS No. 158, the Company recorded a minimum pension liability in 2005 which reversed in 2006.			
Regulatory asset	\$ 1,906,068	\$ -	\$ -
Benefit plan liability	3,855,292	-	-
Deferred tax liability	(258,575)	238,366	(238,366)
Accrued expenses	(1,268,764)	(627,278)	627,278

(Concluded)

See notes to consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED SEPTEMBER 30, 2007, 2006, AND 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General—RGC Resources, Inc. is an energy services company 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 (“Roanoke Gas”); Diversified Energy Company; and RGC Ventures, Inc. of Virginia, operating as Application Resources. Roanoke Gas is a natural gas utility, which distributes and sells natural gas to residential, commercial and industrial customers within its service areas in Roanoke, VA and the surrounding areas. Application Resources provides information system services to software providers in the utility industry.

Roanoke Gas is regulated by the State Corporation Commission (“SCC” or “Virginia Commission”).

The Company’s business is seasonal in nature and weather dependent as a majority of natural gas sales are for space heating during the winter season.

On February 16, 2007, Resources entered into a Purchase and Sale Agreement with ANGD, LLC for the sale of all of the capital stock of Bluefield Gas Company (“Bluefield Gas”), and Roanoke Gas entered into a Purchase and Sale Agreement with Appalachian Natural Gas Distribution Company for the sale of Roanoke Gas’ natural gas distribution assets located in the Town of Bluefield and the County of Tazewell, Virginia (“Bluefield division of Roanoke Gas Company”). Both transactions closed on November 2, 2007 with an effective date of October 31, 2007. In August 2006, Resources sold the assets of Highland Energy, its energy marketing operation that brokered natural gas to industrial transportation customers of Roanoke Gas and Bluefield Gas. These operations have been reflected as discontinued operations in the consolidated financial statements of Resources. With the sale of Highland Energy, Resources has only one reportable segment as defined under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. Please see footnote 2 below for further discussions on the sale of Bluefield Gas, the assets of the Bluefield division of Roanoke Gas Company and certain assets of Highland Energy.

All intercompany transactions have been eliminated in consolidation.

Rate Regulated Basis of Accounting—The Company’s regulated operations follow the accounting and reporting requirements of Statement of Financial Accounting Standards (“SFAS”) No. 71, *Accounting for the Effects of Certain Types of Regulation*. 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 results, 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).

Regulatory assets and liabilities included in the Company's consolidated balance sheets as of September 30, 2007 and 2006 are as follows:

	<u>September 30</u>	
	<u>2007</u>	<u>2006</u>
Regulatory assets:		
Premium on early retirement of debt	\$ 248,077	\$ 278,454
Benefit plan assets	1,906,068	-
Other	<u>11,945</u>	<u>11,945</u>
 Total regulatory assets	 <u>\$ 2,166,090</u>	 <u>\$ 290,399</u>
Regulatory liabilities:		
Over-recovery of gas costs	\$ 567,295	\$ 2,112,256
Regulatory cost of retirement obligation	6,043,088	5,319,198
Asset retirement obligation	2,499,345	2,404,839
Other	<u>330</u>	<u>2,447</u>
 Total regulatory liabilities	 <u>\$ 9,110,058</u>	 <u>\$ 9,838,740</u>

Utility Plant and Depreciation—Utility plant is stated at original cost. The cost of additions to utility plant includes direct charges and overhead. The cost of depreciable property retired is charged to accumulated depreciation. The cost of asset removals, less salvage, is charged to “regulatory cost of retirement obligations” or “asset retirement obligations” as explained in footnote 13. Maintenance, repairs, and minor renewals and betterments of property are charged to operations and maintenance.

Provisions for depreciation are computed principally at composite straight-line rates with annual composite rates ranging up to 17% for utility property. The annual composite rates for utility property are determined by periodic depreciation studies that are approved by the SCC. The Virginia Commission requires Roanoke Gas to conduct a depreciation study every five years and propose new depreciation rates for approval. The results of Roanoke Gas' last depreciation study were placed into effect January 1, 2004.

The composite rates are comprised of two components, one based on average service life and one based on cost of retirement. Therefore, the Company accrues the estimated cost of retirement of long-lived assets through depreciation expense. Retirement costs are not a legal obligation as defined by SFAS No. 143 but rather the result of cost-based regulation and are accounted for under the provisions of SFAS No. 71. Therefore, such amounts are classified as a regulatory liability. See footnote 13 regarding legal obligations related to asset retirements.

The Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Our reviews have not identified a material effect on results of operations or financial condition.

Cash, Cash Equivalents and Short-Term Investments—For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Reserve for Bad Debts—The Company provides an estimate for losses on accounts receivable utilizing historical information, current account balances, account aging and current economic conditions.

Inventories—Inventories consist of natural gas in storage and materials and supplies. Inventories are recorded at average cost.

Unbilled Revenues—The Company bills its natural gas customers on a monthly cycle basis; however, the billing cycle period for most customers does not coincide with the accounting periods used for financial reporting and, therefore, accrues estimates for natural gas delivered to customers not yet billed during the accounting period. The Company recognizes revenue when gas is delivered. The amounts of unbilled revenue receivable included in accounts receivable on the consolidated balance sheets at September 30, 2007 and 2006 were \$1,287,362 and \$1,462,878, respectively.

Income Taxes—Income taxes are accounted for using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the years in which those temporary differences are expected to be recovered or settled. A valuation allowance against deferred tax assets is provided if it is more likely than not the deferred tax asset will not be realized. The Company and its subsidiaries file a consolidated income tax return.

Debt Expenses—Debt issuance expenses are being amortized over the lives of the debt instruments.

Over/Under Recovery of Natural Gas Costs—Pursuant to the provisions of the Company’s Purchased Gas Adjustment (“PGA”) clause, increases or decreases in natural gas costs incurred by regulated operations, including gains and losses on derivative hedging instruments, are passed through to customers. Accordingly, the difference between actual costs incurred and costs recovered through the application of the PGA is reflected as a regulatory asset or liability. At the end of the deferral period, the balance of the net deferred charge or credit is amortized over an ensuing 12-month period as amounts are reflected in customer billings.

Use of Estimates—The preparation of financial statements in conformity with Generally Accepted Accounting Principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent 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.

Reclassifications—Certain prior period amounts have been reclassified to conform to current year presentation. Specifically, the Company reclassified certain financial statement items including footnote information for 2006 and 2005 to reflect the effect of discontinued operations discussed in footnote 2. The Company reclassified “non-utility property” and related “accumulated depreciation” into the corresponding utility property accounts. The Company also reclassified “refunds from suppliers – due customers” to “accrued expenses”.

Earnings Per Share—Basic earnings per share and diluted earnings per share are calculated by dividing net income by the weighted average common shares outstanding during the period and the weighted average common shares outstanding during the period plus dilutive potential common shares, respectively. 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 to diluted average common shares is provided below:

	Year Ended September 30		
	2007	2006	2005
Weighted average common shares	2,162,803	2,120,267	2,079,851
Effect of dilutive securities:			
Options to purchase common stock	<u>10,455</u>	<u>10,453</u>	<u>13,264</u>
Diluted average common shares	<u>2,173,258</u>	<u>2,130,720</u>	<u>2,093,115</u>

Business and Credit Concentrations—The primary business of the Company is the distribution of natural gas to residential, commercial and industrial customers in its service territories. The level of natural gas requirements by certain industrial customers may result in a level of concentration above 5% of total sales or total accounts receivable for the periods reported.

No regulated sales to individual customers accounted for more than 5% of total revenue in any period.

Roanoke Gas is served by multiple natural gas transmission pipelines; however, by the stage of physical interconnection with the company's distribution facilities the transmission of natural gas has consolidated into two primary pipelines. Depending upon 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.

Derivative and Hedging Activities—SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, requires the recognition of all derivative instruments as assets or liabilities in the Company's balance sheet and measurement of those instruments at fair value.

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 RGC Resources, Inc. hedges against include the price of natural gas and the cost of borrowed funds.

The Company enters into collars, swaps and caps for the purpose of hedging the price of natural gas in order to provide price stability during the winter months. The fair value of these instruments is recorded in the balance sheet with the offsetting entry to either under-recovery of gas costs or over-recovery of gas costs. 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 PGA. The Virginia Commission allows 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. At September 30, 2007, the Company has collar agreements outstanding for the winter period to hedge 680,000 decatherms of natural gas, and the futures price for delivery of natural gas during the periods hedged fell between the upper and lower limits of the collar contracts.

The Company also 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 on LIBOR into fixed rate debt with a 5.74% interest rate. The swap qualifies as a cash flow hedge with changes in fair value reported in other comprehensive income.

No derivative instruments were deemed to be ineffective as defined under SFAS No. 133 for any period.

Other Comprehensive Income—A summary of other comprehensive income and financial instrument activity including the effect of adopting SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, is provided below:

Year Ended September 30, 2007	Interest Rate Swap	Natural Gas Derivative	SFAS No. 158	Total
Unrealized losses	\$ (37,233)	\$ -	\$ -	\$ (37,233)
Income tax benefit	14,134	-	-	14,134
Net unrealized losses	<u>(23,099)</u>	<u>-</u>	<u>-</u>	<u>(23,099)</u>
Transfer of realized gains to income	(44,233)	-	-	(44,233)
Income tax expense	16,790	-	-	16,790
Net transfer of realized gains to income	<u>(27,443)</u>	<u>-</u>	<u>-</u>	<u>(27,443)</u>
Net other comprehensive loss	<u>\$ (50,542)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (50,542)</u>
Fair value of marked to market transactions	<u>\$ (86,025)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (86,025)</u>
Accumulated comprehensive loss	<u>\$ (53,370)</u>	<u>\$ -</u>	<u>\$ (421,885)</u>	<u>\$ (475,255)</u>

Year Ended September 30, 2006	Interest Rate Swap	Natural Gas Derivative	Minimum Pension Liability	Total
Unrealized gains (losses)	\$ (29,000)	\$ -	\$ 627,278	\$ 598,278
Income tax (expense) benefit	11,008	-	(238,366)	(227,358)
Net unrealized gains (losses)	<u>(17,992)</u>	<u>-</u>	<u>388,912</u>	<u>370,920</u>
Transfer of realized losses to income	10,835	-	-	10,835
Income tax benefit	(4,112)	-	-	(4,112)
Net transfer of realized losses to income	<u>6,723</u>	<u>-</u>	<u>-</u>	<u>6,723</u>
Net other comprehensive income (loss)	<u>\$ (11,269)</u>	<u>\$ -</u>	<u>\$ 388,912</u>	<u>\$ 377,643</u>
Fair value of marked to market transactions	<u>\$ (4,559)</u>	<u>\$ (1,482,140)</u>	<u>\$ -</u>	<u>\$ (1,486,699)</u>
Accumulated comprehensive loss	<u>\$ (2,828)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (2,828)</u>

Year Ended September 30, 2005	Interest Rate Swap	Natural Gas Derivative	Minimum Pension Liability	Total
Unrealized gains (losses)	\$ 54,634	\$ -	\$ (627,278)	\$ (572,644)
Income tax (expense) benefit	(20,739)	-	238,366	217,627
Net unrealized gains (losses)	33,895	-	(388,912)	(355,017)
Transfer of realized losses to income	32,328	-	-	32,328
Income tax benefit	(12,272)	-	-	(12,272)
Net transfer of realized losses to income	20,056	-	-	20,056
Net other comprehensive income (loss)	\$ 53,951	\$ -	\$ (388,912)	\$ (334,961)
Fair value of marked to market transactions	\$ 13,606	\$ -	\$ -	\$ 13,606
Accumulated comprehensive loss	\$ 8,441	\$ -	\$ (388,912)	\$ (380,471)

Stock-Based Compensation—On October 1, 2005, the Company adopted SFAS No. 123R, *Share-Based Payment*, a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. This statement eliminates the alternative to use the intrinsic value method of accounting as prescribed under Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*. Under APB Opinion No. 25, the Company did not recognize stock-based employee compensation expense related to its Key Employees Stock Option Plan (“Plan”) in net income as all options granted under the Plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. SFAS No. 123R requires entities to recognize the cost of employee services received in exchange for awards of equity instruments using a fair-value-based method on the grant-date. The Company has adopted the provisions of this statement using the modified prospective application. Under the modified prospective application, only new grants and grants that have been modified, cancelled or have not yet vested as of the effective date of the statement require recognition of compensation cost. All awards granted and vested prior to the effective date remain under the provisions of APB Opinion No. 25. No options were granted in fiscal 2007, 2006 and 2005 and all outstanding options were fully vested at the date of adoption.

New Accounting Standards— In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109*. This statement clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. This Interpretation prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The recognition threshold is based upon whether it is more-likely-than-not that a tax position taken by an enterprise will be sustained upon examination. The measurement attribute of a more-likely-than-not tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The effective date of this statement is for the Company’s first quarter of fiscal year ending September 30, 2008. The Company has not completed its evaluation of this statement but does not anticipate the adoption to have a material impact on the Company’s financial position or results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value methods. This statement does not require any new fair value measurements. Instead, it provides for increased consistency and comparability in fair value measurements and for expanded disclosure surrounding the fair value measurements. This statement is effective for fiscal years beginning after November 15, 2007. The Company does not anticipate the adoption of this statement to have a material impact on the Company's financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132R* ("SFAS No. 158"). This statement requires employers who sponsor one or more single-employer defined benefit plans to recognize the overfunded or underfunded position of such plan(s) as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. This statement also requires the measurement of the defined benefit plan assets and obligations as of the date of the employer's balance sheet date and additional disclosures in the financial statement footnotes. The effective date of this statement is for fiscal years ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the fiscal year end balance sheet date is effective for fiscal years ending after December 15, 2008. The adoption of SFAS No. 158 resulted in the Company recording an additional benefit liability of \$2,586,528 associated with the net underfunded positions of its defined benefit pension plan and post-retirement benefit plan. The Company also recorded a regulatory asset of \$1,906,068 associated with the regulated operations of Roanoke Gas in accordance with the provisions of SFAS No. 71 whereby the Company believes that it will continue to be able to recover the change in funded status of the plans through future rates. The Company also recognized other comprehensive loss of \$421,885, net of tax, for the associated liabilities not associated with the regulated operations. Footnote 7 includes more information regarding the effect of SFAS No. 158.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. This statement permits, but does not require, entities to choose to measure selected financial assets and liabilities at fair value. Although SFAS No. 159 does not eliminate the fair value disclosure requirements included in other accounting standards, it does provide for additional presentation and disclosures designed to facilitate comparisons between companies that choose different measurement attributes for similar assets and liabilities. The effective date of this statement is for fiscal years beginning after November 15, 2007. The Company has not completed its evaluation of this statement, nor determined the potential effect on its financial position, results of operations or cash flows.

2. DISCONTINUED OPERATIONS

On February 16, 2007, Resources entered into a Purchase and Sale Agreement with ANGD, LLC ("ANGD"), for the sale of all of the capital stock of Bluefield Gas Company, a wholly owned subsidiary of Resources, to ANGD. The sales price is equal to the book value of Bluefield Gas' 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 prior to Closing, (ii) inter-company receivables or payables existing between Bluefield Gas and the Company (including its other affiliates) will be settled as of Closing, and (iii) the Company will pay off Bluefield Gas outstanding debt at Closing out of the sales proceeds.

Also on February 16, 2007, Roanoke Gas entered into an Asset Purchase and Sale Agreement with Appalachian Natural Gas Distribution Company (“Appalachian”) for the sale of Roanoke Gas’ 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. The sales price is 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 sales price is 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.

Although the Purchase and Sale Agreement with ANGD, LLC for the sale of the capital stock of Bluefield Gas provides 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 has in the stock is significantly less than the book basis. This lower tax basis has resulted in the recording of an estimated income tax expense attributable to the anticipated taxable gain for the excess of the book basis of the assets over the tax basis. The current estimate of tax liability expected to be realized on this transaction is reflected as part of income tax expense in discontinued operations.

Bluefield Gas and the Bluefield division of Roanoke Gas Company (“Bluefield Operations”) represent approximately 4,600 of Resources’ 60,000 customers and approximately \$12,800,000 of the consolidated assets and \$7,600,000 of the consolidated liabilities of the Company as of September 30, 2007 as reflected below. The sale of the Bluefield Operations closed effective as of October 31, 2007.

The Board of Directors approved the Purchase and Sale Agreements of Bluefield Gas and the Bluefield division of Roanoke Gas Company for several reasons. The management time and effort required to oversee Bluefield operations were significantly disproportionate to the size of these operations. The regulatory environment in West Virginia has historically 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 led 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 Company received regulatory approvals from the respective regulatory commissions in Virginia and West Virginia prior to the end of the Company’s fiscal year. The operations of both Bluefield Gas and Bluefield Division of Roanoke Gas Company were classified as discontinued operations in accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, as the pending sale met the probable definition requirement. Both transactions closed on November 2, 2007 with an effective date of October 31, 2007.

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. Under the agreement, a portion of the purchase price was deferred as realization of those revenues was subject to certain provisions. The Company met substantially all of the provisions of the agreement and recorded \$160,162 gain on sale of assets in final settlement of the sales contract as part of discontinued operations in 2007.

In June 2005, the Company sold 10 parcels of real estate consisting of bulk propane storage facilities and office space owned by Diversified Energy Company. These properties were originally part of the propane operations that were sold to Inergy Propane, LLC (“Inergy”) in 2004, but were retained and leased to Inergy with an option to purchase. Inergy exercised its option to purchase all properties in 2005 and the corresponding rental activities and gain on sale of the real estate were recorded in discontinued operations for that period.

The activities associated with the Bluefield Operations, Highland Energy and the real estate operations are included in discontinued operations and are summarized as follows:

	Years Ended September 30		
	2007	2006	2005
Bluefield Operations			
Total Revenues	<u>\$ 11,229,432</u>	<u>\$ 13,206,878</u>	<u>\$ 11,475,831</u>
Pretax Operating Loss	(134,650)	(181,671)	(279,258)
Continuing Costs	773,304	732,007	684,987
Income Tax Expense	<u>(745,598)</u>	<u>(237,544)</u>	<u>(174,887)</u>
Discontinued Operations	<u>\$ (106,944)</u>	<u>\$ 312,792</u>	<u>\$ 230,842</u>
Highland Energy			
Revenues	<u>\$ -</u>	<u>\$ 21,962,564</u>	<u>\$ 21,571,120</u>
Gain on Sale of Assets	160,162	233,216	-
Pretax Operating Income	77,560	98,743	331,420
Continuing Costs	-	49,992	55,928
Income Tax Expense	<u>(90,238)</u>	<u>(145,014)</u>	<u>(147,055)</u>
Discontinued Operations	<u>\$ 147,484</u>	<u>\$ 236,937</u>	<u>\$ 240,293</u>
Real Estate			
Revenues	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 39,366</u>
Gain on Sale of Assets	-	-	153,147
Pretax Operating Income	-	-	39,366
Continuing Costs	-	-	-
Income Tax Expense	<u>-</u>	<u>-</u>	<u>(73,540)</u>
Discontinued Operations	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 118,973</u>
Total			
Revenues	<u>\$ 11,229,432</u>	<u>\$ 35,169,442</u>	<u>\$ 33,086,317</u>
Gain on Sale of Assets	160,162	233,216	153,147
Pretax Operating Income (Loss)	(57,090)	(82,928)	91,528
Continuing Costs	773,304	781,999	740,915
Income Tax Expense	<u>(835,836)</u>	<u>(382,558)</u>	<u>(395,482)</u>
Discontinued Operations	<u>\$ 40,540</u>	<u>\$ 549,729</u>	<u>\$ 590,108</u>

The carrying amounts of the major classes of assets and liabilities subject to the purchase agreements at September 30, 2007 and 2006 are as follows:

	September 30	
	2007	2006
Assets:		
Accounts receivable, net	\$ 429,582	\$ 658,551
Gas in storage	3,230,624	3,399,639
Other current assets	90,913	619,862
Net utility plant	9,018,903	8,962,113
Other assets	<u>55,322</u>	<u>86,626</u>
Assets available for sale	<u>\$ 12,825,344</u>	<u>\$ 13,726,791</u>
Liabilities:		
Accounts payable and customer credit balances	\$ 1,499,604	\$ 1,499,143
Accrued expenses	99,821	217,054
Other current liabilities	4,800,048	3,442,251
Non-current liabilities	<u>1,159,132</u>	<u>3,094,015</u>
Liabilities of assets available for sale	<u>\$ 7,558,605</u>	<u>\$ 8,252,463</u>

The purchase agreements related to the sale of the Bluefield Operations provide, 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.

3. ALLOWANCE FOR DOUBTFUL ACCOUNTS

A summary of the changes in the allowance for doubtful accounts follows:

	Years Ended September 30		
	2007	2006	2005
Balances, beginning of year	\$ 26,584	\$ 73,725	\$ 25,866
Provision for doubtful accounts	120,671	354,947	282,313
Recoveries of accounts written off	294,887	213,503	264,825
Accounts written off	<u>(395,432)</u>	<u>(615,591)</u>	<u>(499,279)</u>
Balances, end of year	<u>\$ 46,710</u>	<u>\$ 26,584</u>	<u>\$ 73,725</u>

The amounts above are exclusive of the Bluefield operations.

4. BORROWINGS UNDER LINES-OF-CREDIT

The Company has available unsecured lines-of-credit with a bank which will expire March 31, 2008. The Company anticipates being able to extend or replace the lines-of-credit. The Company's

available unsecured lines-of-credit vary during the year to accommodate its seasonal borrowing demands. Generally, the Company's borrowing needs are at their lowest in spring, increase during the summer and fall due to gas storage purchases and construction expenditures and reach their maximum levels in winter. Available limits under these agreements for the remaining term are as follows:

Effective	Available Line of Credit
September 30, 2007	\$ 17,000,000
November 16, 2007	21,000,000
February 16, 2008	16,000,000

A summary of the lines-of-credit follows:

	2007	2006	2005
Lines-of-credit at year-end	\$ 17,000,000	\$ 20,000,000	\$ 20,000,000
Outstanding balance at year-end	4,808,000	3,353,000	4,025,000
Highest month-end balances outstanding	8,421,000	17,827,000	14,016,000
Average month-end balances	2,715,000	6,565,000	6,334,000
Average rates of interest during year	5.83%	4.86%	2.94%
Average rates of interest on balances outstanding at year-end	5.62%	5.82%	4.36%

5. LONG-TERM DEBT

Long-term debt consists of the following:

	September 30	
	2007	2006
First Mortgage notes payable, at 7.804%, due July 1, 2008	\$ 5,000,000	\$ 5,000,000
Unsecured senior notes payable, at 7.66%, with provision for retirement of \$1,600,000 each year beginning December 1, 2014 through December 1, 2018	8,000,000	8,000,000
Unsecured note payable, with variable interest rate based on 30-day LIBOR (5.13% at September 30, 2007) plus 69 basis point spread, with provision for retirement on December 1, 2010	<u>15,000,000</u>	<u>15,000,000</u>
Total long-term debt	28,000,000	28,000,000
Less current maturities	<u>(5,000,000)</u>	<u>-</u>
Total long-term debt—excluding current maturities	<u>\$ 23,000,000</u>	<u>\$ 28,000,000</u>

The above debt obligations contain various provisions, including a minimum interest charge coverage ratio and limitations on debt as a percentage of total capitalization. The obligations also contain a provision restricting the payment of dividends, primarily based on the earnings of the

Company and dividends previously paid. The Company was in compliance with these provisions at September 30, 2007 and 2006. At September 30, 2007, approximately \$12,283,000 of retained earnings were available for dividends.

The First Mortgage notes are secured by the Company's land and buildings.

The aggregate annual maturities of long-term debt, subsequent to September 30, 2007, are as follows:

Years Ended September 30	Maturities
2008	\$ 5,000,000
2009	-
2010	-
2011	15,000,000
2012	-
Thereafter	<u>8,000,000</u>
Total	<u>\$ 28,000,000</u>

6. INCOME TAXES

The details of income tax expense (benefit) from continuing operations are as follows:

	<u>Years Ended September 30</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Current income taxes:			
Federal	\$ 806,956	\$ 1,448,286	\$ 1,491,928
State	<u>113,461</u>	<u>232,491</u>	<u>301,527</u>
Total current income taxes	<u>920,417</u>	<u>1,680,777</u>	<u>1,793,455</u>
Deferred income taxes:			
Federal	1,100,072	8,990	(16,384)
State	<u>246,407</u>	<u>44,929</u>	<u>(26,058)</u>
Total deferred income taxes	<u>1,346,479</u>	<u>53,919</u>	<u>(42,442)</u>
Amortization of investment tax credits	<u>(30,488)</u>	<u>(32,281)</u>	<u>(33,168)</u>
Total income tax expense	<u>\$ 2,236,408</u>	<u>\$ 1,702,415</u>	<u>\$ 1,717,845</u>

Income tax expense for the years ended September 30, 2007, 2006 and 2005 differed from amounts computed by applying the U.S. Federal income tax rate of 34 percent to earnings before income taxes as a result of the following:

	<u>Years Ended September 30</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Income before income taxes	<u>\$ 6,002,077</u>	<u>\$ 4,664,217</u>	<u>\$ 4,634,643</u>
Income tax expense computed at the federal statutory rate	\$ 2,040,706	\$ 1,585,834	\$ 1,575,779
Increase (reduction) in income tax expense resulting from:			
State income taxes, net of federal income tax benefit	237,513	183,097	181,810
Amortization of investment tax credits	(30,488)	(32,281)	(33,168)
Other—net	<u>(11,323)</u>	<u>(34,235)</u>	<u>(6,576)</u>
Total income tax expense	<u>\$ 2,236,408</u>	<u>\$ 1,702,415</u>	<u>\$ 1,717,845</u>

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities are as follows:

	<u>September 30</u>	
	<u>2007</u>	<u>2006</u>
Deferred tax assets:		
Allowance for uncollectibles	\$ 18,838	\$ 73,197
Accrued pension and post-retirement medical benefits	1,454,905	1,282,947
Accrued vacation	187,173	184,857
Over recovery of gas costs	215,346	1,364,433
Costs of gas held in storage	853,169	825,850
Deferred compensation	338,891	258,231
Other	<u>202,170</u>	<u>126,199</u>
Total deferred tax assets	<u>3,270,492</u>	<u>4,115,714</u>
Deferred tax liabilities:		
Utility plant	7,054,425	6,759,555
Accrued gas costs	51,630	53,357
Sale of Bluefield Gas stock	<u>605,838</u>	<u>-</u>
Total deferred tax liabilities	<u>7,711,893</u>	<u>6,812,912</u>
Net deferred tax liability	<u>\$ 4,441,401</u>	<u>\$ 2,697,198</u>

7. EMPLOYEE BENEFIT PLANS

The Company sponsors both a defined benefit plan and a postretirement benefit plan ("Plans"). The defined benefit plan covers substantially all employees and benefits fully vest after five years of credited service. Benefits paid to retirees are based on age at retirement, years of service and average compensation. The postretirement benefit plan provides certain healthcare, supplemental retirement and life insurance benefits to retired employees who meet specific age and service requirements.

On September 30, 2007, the Company adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132R* (SFAS No. 158). This Standard retains the previous periodic expense calculation on an actuarial basis under the provisions of SFAS No. 87, *Employers' Accounting for Pensions* and SFAS No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions*. In addition, this statement also requires an employer to recognize the overfunded or underfunded status of defined benefit pensions and other postretirement plans as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. For pension plans, the benefit obligation is the projected benefit obligation, and for other postretirement plans, the benefit obligation is the accumulated benefit obligation. The Company established a regulatory asset for the portion of the obligation expected to be recovered in rates in future periods in accordance with SFAS No. 71. The portion of the obligation attributable to the unregulated operations of the holding company parent is recognized in comprehensive income. SFAS No. 158 also requires an employer to measure the funded status of each plan as of the Company's fiscal year end for fiscal years ending after December 31, 2008. The Company currently uses a June 30 measurement date for its benefit plans.

The following table summarizes the effect of the adoptions of SFAS No. 158 on the Company's financial statements as of September 30, 2007:

	Before Application of <u>SFAS No. 158</u>	Effect of <u>SFAS No. 158</u>	After Application of <u>SFAS No. 158</u>
Regulatory assets	\$ -	\$ 1,906,068	\$ 1,906,068
Benefit liabilities	1,268,764	2,586,528	3,855,292
Accumulated other comprehensive loss, net of tax	-	(421,885)	(421,885)

The following tables set forth the benefit obligation, fair value of plan assets, and the funded status of the Plans; amounts recognized in the Company's financial statements and the assumptions used:

	<u>Pension Benefits</u>		<u>Postretirement Benefits</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Accumulated benefit obligation	<u>\$ 9,364,621</u>	<u>\$ 9,106,162</u>	<u>\$ 8,427,326</u>	<u>\$ 8,266,411</u>
Change in projected benefit obligation:				
Benefit obligation at beginning of year	\$12,102,103	\$13,488,753	\$ 8,266,411	\$ 9,612,853
Service cost	404,909	477,279	147,693	164,539
Interest cost	740,918	695,593	501,838	481,368
Participant contributions	-	-	44,042	49,675
Plan amendments	-	-	-	(343,313)
Actuarial gain	(307,353)	(2,102,764)	(113,471)	(1,193,081)
Benefit payments	<u>(402,277)</u>	<u>(456,758)</u>	<u>(419,187)</u>	<u>(505,630)</u>
Benefit obligation at end of year	<u>\$12,538,300</u>	<u>\$12,102,103</u>	<u>\$ 8,427,326</u>	<u>\$ 8,266,411</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 9,248,810	\$ 8,424,279	\$ 4,212,556	\$ 3,586,307
Actual return on plan assets	1,312,622	506,289	624,768	245,374
Employer contributions	825,000	775,000	770,000	896,830
Participant contributions	-	-	44,042	49,675
Tax payments	-	-	(30,000)	(60,000)
Benefit payments	<u>(402,277)</u>	<u>(456,758)</u>	<u>(419,187)</u>	<u>(505,630)</u>
Fair value of plan assets at end of year	<u>\$10,984,155</u>	<u>\$ 9,248,810</u>	<u>\$ 5,202,179</u>	<u>\$ 4,212,556</u>
Reconciliation of funded status:				
Funded status	\$ (1,554,145)	\$ (2,853,293)	\$ (3,225,147)	\$ (4,053,855)
Unrecognized actuarial gain	N/A	1,986,054	N/A	947,260
Unrecognized transition obligation	N/A	-	N/A	1,322,246
Contributions made between the measurement date and fiscal year-end	<u>200,000</u>	<u>225,000</u>	<u>724,000</u>	<u>770,000</u>
Net amount recognized	<u>\$ (1,354,145)</u>	<u>\$ (642,239)</u>	<u>\$ (2,501,147)</u>	<u>\$ (1,014,349)</u>
Amounts recognized in the balance sheets consist of:				
Noncurrent liabilities	<u>\$ (1,354,145)</u>		<u>\$ (2,501,147)</u>	
Amounts recognized in accumulated other comprehensive loss:				
Transition obligation, net of tax	\$ -		\$ 175,671	
Net actuarial loss, net of tax	<u>160,387</u>		<u>85,827</u>	
Total amounts included in other comprehensive loss, net of tax	<u>\$ 160,387</u>		<u>\$ 261,498</u>	

The Company established regulatory assets of \$726,454 and \$1,179,614 as of September 30, 2007 for the portion of the pension and postretirement obligations to be recovered through rates in future periods in accordance with SFAS No. 71.

The Company is amortizing the unrecognized transition obligation over a remaining life of 6 years and projects approximately \$29,000 of other comprehensive loss to be recognized as a component of net periodic benefit cost for the year ended September 30, 2008.

The following table details the actuarial assumptions used in determining the projected benefit obligations and net benefit cost of the pension and the accumulated benefit obligations and net benefit cost of the postretirement plan for 2007, 2006 and 2005:

	Pension Benefits			Postretirement Benefits		
	2007	2006	2005	2007	2006	2005
Assumptions related to benefit obligations:						
Discount rate	6.25%	6.25%	5.25%	6.25%	6.25%	5.25%
Expected rate of compensation increase	5.00%	5.00%	5.00%	N/A	N/A	N/A
Assumptions related to benefit costs:						
Discount rate	6.25%	5.25%	6.25%	6.25%	5.25%	6.25%
Expected long-term rate of return on plan assets	7.50%	7.50%	7.50%	7.00%	7.00%	7.00%
Expected rate of compensation increase	5.00%	5.00%	5.00%	N/A	N/A	N/A

To develop the expected long-term rate of return on assets assumption, the Company considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of each plan's portfolio. This resulted in the selection of the corresponding long-term rate of return assumptions used for each plan's assets.

	Pension Plan			Postretirement Plan		
	2007	2006	2005	2007	2006	2005
Components of net periodic pension cost:						
Service cost	\$ 404,909	\$ 477,279	\$ 327,424	\$ 147,693	\$ 164,539	\$128,972
Interest cost	740,918	695,593	631,731	501,838	481,368	444,267
Expected return on plan assets	(691,262)	(628,273)	(571,881)	(238,896)	(215,026)	(185,810)
Amortization of unrecognized transition obligation	-	-	-	188,892	200,994	237,300
Recognized loss	<u>72,225</u>	<u>240,307</u>	<u>62,395</u>	<u>9,887</u>	<u>78,969</u>	<u>-</u>
Net periodic benefit cost	<u>\$ 526,790</u>	<u>\$ 784,906</u>	<u>\$ 449,669</u>	<u>\$ 609,414</u>	<u>\$ 710,844</u>	<u>\$624,729</u>

Actuarial estimates for the postretirement benefit plan assumed a weighted average annual rate increase in the per capita cost of covered health care benefits (i.e., medical trend rate) of 9%, 10%, and 9% for 2007, 2006 and 2005, respectively. The rates were assumed to decrease gradually to 5% by 2011 and remain at that level thereafter. Assumed medical trend rates have a significant effect on the amounts reported. A 1% point change in assumed healthcare cost trend rates would have the following effects:

	1% Point Increase	1% Point Decrease
Effect on total service and interest cost components	\$ 94,808	\$ (77,294)
Effect on accumulated postretirement benefit obligation	1,008,371	(836,137)

The Company's target and actual asset allocation in the pension and postretirement benefit plans as of June 30 were:

	Pension Plan			Postretirement Benefit Plan		
	Target	2007	2006	Target	2007	2006
Asset category:						
Equity securities	50%-70%	60%	61%	35%-65%	51%	50%
Debt securities	30%-50%	34%	36%	35%-65%	41%	42%
Other	0%-20%	6%	3%	0%-20%	8%	8%

The primary objectives of the Company's investment policy are to maintain investment portfolios that diversify risk through prudent asset allocation parameters, achieve asset returns that meet or exceed the plans' actuarial assumptions, achieve asset returns that are competitive with like institutions employing similar investment strategies and meet expected future benefits. The investment policy is periodically reviewed by the Company and a third-party fiduciary.

The Company expects to contribute \$600,000 to its pension plan and \$600,000 to its postretirement benefit plan in 2008.

The following table reflects expected future benefit payments.

Fiscal year ending September 30	Pension Plan	Postretirement Benefit Plan
2008	\$ 410,000	\$ 490,000
2009	423,000	497,000
2010	435,000	501,000
2011	465,000	512,000
2012	512,000	515,000
2013-2017	3,193,000	2,784,000

The Company also sponsors a defined contribution plan/401k ("Plan") covering all employees who elect to participate. Employees may contribute from 1% to 50% of their annual compensation to the

Plan, limited to a maximum annual amount as set periodically by the Internal Revenue Service. The Company makes matching contributions to the plan with a 100% match on the participants' first 3% of contributions and 50% on the next 3% of contributions. Company matching contributions were \$240,946, \$233,327 and \$229,441 for 2007, 2006 and 2005, respectively.

8. COMMON STOCK OPTIONS

The Company's stockholders approved the RGC Resources, Inc. Key Employee Stock Option Plan ("KESOP"). The KESOP provides for the issuance of common stock options to officers and certain other full-time salaried employees to acquire a maximum of 100,000 shares of the Company's common stock. The KESOP requires each option's exercise price per share to equal the fair value of the Company's common stock as of the date of the grant. As of September 30, 2007, the number of shares available for future grants under the KESOP is 2,000 shares.

The aggregate number of shares under option pursuant to the KESOP are as follows:

	Number of Shares	Weighted- Average Price	Option Price Per Share
Options outstanding, September 30, 2004	53,500	\$ 19.288	\$15.500-\$20.875
Options exercised	(7,500)	\$ 17.708	
Options expired	<u>-</u>		
Options outstanding, September 30, 2005	46,000	\$ 19.545	\$16.875-\$20.875
Options exercised	(2,000)	\$ 20.875	
Options expired	<u>-</u>		
Options outstanding, September 30, 2006	44,000	\$ 19.485	\$16.875-\$20.875
Options exercised	(12,500)	\$ 19.425	
Options expired	<u>-</u>		
Options outstanding, September 30, 2007	<u>31,500</u>	\$ 19.508	\$18.100-\$20.875

	Options Outstanding and Exercisable Remaining		
	Shares	Life (Years)	Exercise Price
	9,000	2.2	\$ 20.875
	7,000	3.2	19.250
	9,000	4.2	19.360
	<u>6,500</u>	<u>5.2</u>	<u>18.100</u>
Weighted average	<u>31,500</u>	<u>3.6</u>	<u>\$ 19.508</u>

Under the terms of the KESOP, the options become exercisable six months from the grant date and expire ten years subsequent to the grant date. All options outstanding were fully vested and exercisable at September 30, 2007 and 2006. No options were granted in 2007, 2006 and 2005. The Company received \$242,812 from the exercise of options in 2007.

9. OTHER STOCK PLANS

Dividend Reinvestment and Stock Purchase Plan

The Company offers a Dividend Reinvestment and Stock Purchase Plan (“DRIP”) to shareholders of record for the reinvestment of dividends and the purchase of additional investments of up to \$40,000 per year in shares of common stock of the Company. Under the DRIP plan, the Company issued 28,490, 29,721 and 20,349 shares in 2007, 2006 and 2005, respectively. As of September 30, 2007, the Company had 287,401 shares available for issuance under this plan.

Restricted Stock Plan

The Board of Directors of the Company implemented the Restricted Stock Plan for Outside Directors effective January 27, 1997. The Plan is applicable to not more than 50,000 shares of Resources’ common stock. Under the Plan, a minimum of 40% of the monthly retainer fee paid to each non-employee director of Resources is paid in shares of common stock (“Restricted Stock”). The number of shares of Restricted Stock is calculated each month based on the closing sales price of Resources’ common stock on the NASDAQ National Market on the first day of the month, if the first day of the month is a trading day, or if not, the first trading day prior to the first day of the month. Beginning in fiscal 1998, a participant can, subject to approval of the Board, elect to receive up to 100% of his retainer fee for the fiscal year in Restricted Stock. Resources requires that all dividends or other distributions paid on shares of Restricted Stock be automatically sequestered and reinvested on an immediate or deferred basis in additional Restricted Stock.

The directors received a total of 4,091 shares of Restricted Stock in fiscal 2007, representing \$84,550 in compensation and \$25,013 in dividends reinvested. The directors also received 4,038 shares of Restricted Stock in fiscal 2006, representing \$83,080 in compensation and \$19,662 in dividends reinvested and 3,366 shares of Restricted Stock in fiscal 2005, representing \$68,601 in compensation and \$18,770 in dividends reinvested. As of September 30, 2007, the Company had 19,720 shares available for issuance under this plan.

Stock Bonus Plan

Under the Stock Bonus Plan, executive officers are encouraged to own a position in the Company’s common stock of at least 50% of the amount of their annual salary. To promote this policy, the Plan provides that all officers with stock ownership positions below 50% of their annual salaries must, unless approved by the Compensation Committee of the Board of Directors, receive no less than 50% of any performance bonus in the form of Company common stock. Under the Stock Bonus Plan, the Company issued 2,462, 3,899 and 2,314 shares valued at \$68,573, \$101,438 and \$61,895, respectively, in 2007, 2006 and 2005. As of September 30, 2007, the Company had 23,779 shares available for issuance under this plan.

10. ENVIRONMENTAL MATTER

Both Roanoke Gas and Bluefield Gas, subsidiaries of RGC Resources, Inc., operated manufactured gas plants (“MGPs”) as a source of fuel for lighting and heating until the late 1940s or early 1950s. A by-product of operating MGPs was coal tar, and the potential exists for on-site tar waste

contaminants at the former plant sites. The extent of contaminants at these sites, if any, is unknown at this time. An analysis at the Bluefield Gas site indicates some soil contamination. The Company, with concurrence of legal counsel, does not believe any events have occurred requiring regulatory reporting. Further, the Company has not received any notices of violation or liabilities associated with environmental regulations related to the MGP sites and is not aware of any off-site contamination or pollution as a result of prior operations. Therefore, the Company has no plans for subsurface remediation at the MGP sites. Should the Company eventually be required to remediate either site, the Company will pursue all prudent and reasonable means to recover any related costs, including insurance claims and regulatory approval for rate case recognition of expenses associated with any work required. A stipulated rate case agreement between the Company and the West Virginia Public Service Commission recognized the right of Bluefield Gas to defer MGP clean-up costs, should any be incurred, and to seek rate recovery for such costs. While the Company is selling the stock of Bluefield Gas to ANGD, it has retained ownership of the former MPG site, and entered into an Indemnification and Cost Sharing Agreement with ANGD and Bluefield Gas concerning the site that requires Bluefield Gas and ANGD to seek recovery of any environmental remediation costs through rate recovery and under any applicable insurance policies or from any third party and to reimburse the Company for 25% of any such costs to the extent they are not otherwise recovered. If the Company eventually incurs costs associated with a required clean-up of the Roanoke Gas MGP site, the Company anticipates recording a regulatory asset for such clean-up costs to be recovered in future rates. Based on anticipated regulatory actions and current practices, management believes that any costs incurred related to this matter will not have a material effect on the Company's financial condition or results of operations.

11. COMMITMENTS

Due to the nature of the natural gas distribution business, the Company has entered into agreements with both suppliers and pipelines to contract for natural gas commodity purchases, storage capacity and pipeline delivery capacity.

The Company obtains most of its regulated natural gas supply under asset management contracts. The Company uses an asset manager to assist in optimizing the use of its transportation, storage rights, and gas supply inventories to provide a reliable source of natural gas supply.

Under the same asset manager contract mentioned above, the Company designated the asset manager as agent for their storage capacity and all gas balances in storage. The asset manager provides agency service and manages the utilization of storage assets and the corresponding withdrawals from and injections into storage. The Company retains physical ownership of storage. Under the provision of the asset management contract, the Company has an obligation to purchase its winter storage requirements during the spring and summer injection periods at market price.

The Company also has contracts for pipeline and storage capacity extending for various periods. These capacity costs and related fees are valued at tariff rates in place as of September 30, 2007. These rates may increase or decrease in the future based upon rate filings and rate orders granting a rate change to the pipeline or storage operator.

The following table reflects the financial and volumetric obligations as of September 30, 2007 for each of the years presented for Roanoke Gas. The table does not include the contracts related to the discontinued operations of Bluefield Gas.

Fiscal Year Ending September 30,	Fixed Price Contracts	Market Price Contracts
	Pipeline and Storage Capacity	Natural Gas Contracts (Decatherms)
2008	\$ 9,729,451	285,985
2009	9,729,451	-
2010	9,729,451	-
2011	9,729,451	-
2012	9,729,451	-

The Company purchased approximately \$60,121,000 in gas under the asset management contracts in fiscal 2007.

Subsequent to September 30, 2007, the Company executed a new asset management agreement effective November 1, 2007. The new three-year asset management agreement will result in additional volumetric obligations of 1,907,195; 2,225,059; 2,225,059 and 317,864 decatherms for fiscal 2008, 2009, 2010 and 2011, respectively.

The Company has historically entered into derivative financial contracts for the purpose of hedging the price of natural gas. As of September 30, 2007, the Company has contracted to hedge a set amount of decatherms of natural gas for each month in the winter period, totaling 680,000 decatherms. All decatherm amounts have a ceiling price of \$9.90 per decatherm and floor prices ranging from \$5.30 to \$7.95 per decatherm; see *Derivative and Hedging Activities* section in footnote 1 for more information.

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of cash and cash equivalents, temporary cash investments, accounts receivable, accounts payable and borrowings under lines of credit are a reasonable estimate of fair value due to their short-term nature and because the rates of interest paid on borrowings under lines-of-credit approximate market rates.

The fair value of long-term debt is estimated by discounting the future cash flows of each issuance at rates currently offered to the Company for similar debt instruments of comparable maturities. The carrying amounts and approximate values for the years ended September 30, 2007 and 2006 are as follows:

	2007		2006	
	Carrying Amounts	Approximate Fair Value	Carrying Amounts	Approximate Fair Value
Long-term debt	\$28,000,000	\$28,934,541	\$28,000,000	\$29,009,682

Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of September 30, 2007 and 2006 are not necessarily indicative of the amounts the Company could have realized in market exchanges.

13. ASSET RETIREMENT OBLIGATIONS

The Company adopted FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47"), as of September 30, 2006. FIN 47 requires that a liability be recognized for an asset retirement obligation which is conditional based on the occurrence of a future event even if the timing or method of settlement is uncertain. SFAS No. 143 and FIN 47 require entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes the cost, thereby increasing the carrying amount of the underlying asset. In subsequent periods, the liability is accreted, and the capitalized cost is depreciated over the useful life of the underlying asset. Under the provisions of FIN 47, the Company recorded asset retirement obligations for its future legal obligations related to purging and capping its distribution mains and services upon retirement, although the timing of such retirements is uncertain. The Company recorded a conditional asset retirement obligation of \$2,499,345 and \$2,404,839 pursuant to its legal obligations upon retirement of its distribution pipeline system as of September 30, 2007 and 2006, respectively.

The Company's composite depreciation rates include a component to provide for the cost of retirement of assets. As a result, the Company accrues estimated cost of retirement of its utility plant through depreciation expense and creates a corresponding regulatory liability in accordance with the provisions of SFAS No. 71. The costs of retirement considered in the development of the depreciation component include those costs associated with the legal liability as defined under SFAS No. 143 and FIN 47. Therefore, at the time of adoption of FIN 47, the Company reclassified a portion of its regulatory liability for cost of retirement to asset retirement obligations for the legal liability as determined above. If the legal obligations would exceed the regulatory liability provided for in the depreciation rates, the Company would establish a regulatory asset for such difference with the anticipation of future recovery through rates charged to customers.

14. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly financial data for the years ended September 30, 2007 and 2006 is summarized as follows:

2007	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating revenues	<u>\$26,417,644</u>	<u>\$37,572,113</u>	<u>\$15,131,375</u>	<u>\$10,780,169</u>
Gross margin	<u>\$ 7,243,434</u>	<u>\$ 8,540,116</u>	<u>\$ 4,947,278</u>	<u>\$ 4,490,948</u>
Operating income	<u>\$ 2,962,789</u>	<u>\$ 4,167,463</u>	<u>\$ 764,884</u>	<u>\$ 63,143</u>
Net income (loss) from continuing operations	<u>\$ 1,511,653</u>	<u>\$ 2,286,035</u>	<u>\$ 236,520</u>	<u>\$ (268,539)</u>
Net income (loss) from discontinued operations	<u>\$ 173,862</u>	<u>\$ 306,669</u>	<u>\$ (459,586)</u>	<u>\$ 19,595</u>
Net income (loss)	<u>\$ 1,685,515</u>	<u>\$ 2,592,704</u>	<u>\$ (223,066)</u>	<u>\$ (248,944)</u>
Basic earnings (loss) per share:				
Continuing operations	\$ 0.70	\$ 1.06	\$ 0.11	\$ (0.13)
Discontinued operations	<u>\$ 0.08</u>	<u>\$ 0.14</u>	<u>\$ (0.21)</u>	<u>\$ 0.01</u>
Net income (loss)	<u>\$ 0.78</u>	<u>\$ 1.20</u>	<u>\$ (0.10)</u>	<u>\$ (0.12)</u>

2006	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating revenues	<u>\$38,384,131</u>	<u>\$33,488,422</u>	<u>\$11,495,048</u>	<u>\$11,223,271</u>
Gross margin	<u>\$ 6,618,623</u>	<u>\$ 7,778,537</u>	<u>\$ 4,387,464</u>	<u>\$ 4,223,648</u>
Operating income	<u>\$ 2,511,910</u>	<u>\$ 3,493,431</u>	<u>\$ 457,497</u>	<u>\$ 214,662</u>
Net income (loss) from continuing operations	<u>\$ 1,211,167</u>	<u>\$ 1,817,998</u>	<u>\$ 26,127</u>	<u>\$ (93,490)</u>
Net income (loss) from discontinued operations	<u>\$ 241,015</u>	<u>\$ 339,076</u>	<u>\$ (83,086)</u>	<u>\$ 52,724</u>
Net income (loss)	<u>\$ 1,452,182</u>	<u>\$ 2,157,074</u>	<u>\$ (56,959)</u>	<u>\$ (40,766)</u>
Basic earnings (loss) per share:				
Continuing operations	\$ 0.58	\$ 0.86	\$ 0.01	\$ (0.05)
Discontinued operations	<u>\$ 0.11</u>	<u>\$ 0.16</u>	<u>\$ (0.04)</u>	<u>\$ 0.03</u>
Net income (loss)	<u>\$ 0.69</u>	<u>\$ 1.02</u>	<u>\$ (0.03)</u>	<u>\$ (0.02)</u>

The pattern of quarterly earnings is the result of the highly seasonal nature of the business, as variations in weather conditions generally result in greater earnings during the winter months.

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