RGC Resources, Inc. and Subsidiaries

Consolidated Financial Statements for the Years Ended September 30, 2015, 2014 and 2013, and Report of Independent Registered Public Accounting Firm

RGC RESOURCES, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	31
CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED SEPTEMBER 30, 2015, 2014 and 2013:	
Consolidated Balance Sheets	32
Consolidated Statements of Income	34
Consolidated Statements of Comprehensive Income	35
Consolidated Statements of Stockholders' Equity	36
Consolidated Statements of Cash Flows	37
Notes to Consolidated Financial Statements	38

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, 2015 and 2014, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended September 30, 2015. RGC Resources, Inc.'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 audits 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. An audit 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 audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RGC Resources, Inc. and Subsidiaries as of September 30, 2015 and 2014, and the consolidated results of its operations and its cash flows for each of the years in the three-year period ended September 30, 2015, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), RGC Resources, Inc. and Subsidiaries' internal control over financial reporting as of September 30, 2015, based on criteria established in *Internal Control-Integrated Framework - 1992* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated December 4, 2015 expressed an unqualified opinion.

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

CERTIFIED PUBLIC ACCOUNTANTS

1715 Pratt Drive, Suite 2700
Blacksburg, Virginia
December 4, 2015

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2015 AND 2014

	2015	2014
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 985,234	$ 849,757
Accounts receivable, net	3,196,573	3,730,173
Materials and supplies	968,108	893,672
Gas in storage	8,160,498	11,402,990
Prepaid income taxes	1,657,066	1,144,214
Deferred income taxes	2,293,536	1,704,320
Under-recovery of gas costs	—	180,831
Other	1,182,343	1,104,660
Total current assets	18,443,358	21,010,617
UTILITY PROPERTY:		
In service	168,033,032	155,360,200
Accumulated depreciation and amortization	(53,307,079)	(50,645,642)
In service, net	114,725,953	104,714,558
Construction work in progress	3,903,599	4,029,019
Utility plant, net	118,629,552	108,743,577
OTHER ASSETS:		
Regulatory assets	10,923,243	9,273,389
Other	144,577	100,058
Total other assets	11,067,820	9,373,447
TOTAL ASSETS	$ 148,140,730	$ 139,127,641

(Continued)

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2015 AND 2014

	2015	2014
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Borrowings under line-of-credit	$ 9,340,997	$ 9,045,050
Dividends payable	912,995	873,326
Accounts payable	5,141,677	5,367,299
Customer credit balances	1,560,351	1,373,927
Customer deposits	1,579,441	1,492,150
Accrued expenses	2,766,097	2,200,882
Over-recovery of gas costs	1,901,426	—
Total current liabilities	23,202,984	20,352,634
LONG-TERM DEBT		
Principal amount	30,500,000	30,500,000
Less unamortized debt issuance costs	(183,427)	(193,081)
Long-term debt net of unamortized debt issuance costs	30,316,573	30,306,919
DEFERRED CREDITS AND OTHER LIABILITIES:		
Asset retirement obligations	5,295,868	4,802,015
Regulatory cost of retirement obligations	8,885,486	8,575,147
Benefit plan liabilities	10,685,261	8,459,436
Deferred income taxes	16,913,567	14,610,643
Total deferred credits and other liabilities	41,780,182	36,447,241
COMMITMENTS AND CONTINGENCIES (Note 9)		
CAPITALIZATION:		
Stockholders' Equity:		
Common stock, $5 par value; authorized 10,000,000 shares; issued and outstanding 4,741,498 and 4,720,378 shares in 2015 and 2014, respectively	23,707,490	23,601,890
Preferred stock, no par; authorized 5,000,000 shares; no shares issued and outstanding in 2015 and 2014	—	—
Capital in excess of par value	8,647,669	8,237,228
Retained earnings	22,772,377	21,321,055
Accumulated other comprehensive loss	(2,286,545)	(1,139,326)
Total stockholders' equity	52,840,991	52,020,847
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 148,140,730	$ 139,127,641

(Concluded)

See notes to consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED SEPTEMBER 30, 2015, 2014 AND 2013

	2015	2014	2013
OPERATING REVENUES:			
Gas utilities	$ 67,094,290	$ 73,865,487	$ 62,024,174
Other	1,095,317	1,150,647	1,181,492
Total operating revenues	68,189,607	75,016,134	63,205,666
COST OF SALES:			
Gas utilities	37,437,315	45,091,274	34,916,062
Other	545,859	587,771	686,713
Total cost of sales	37,983,174	45,679,045	35,602,775
GROSS MARGIN	30,206,433	29,337,089	27,602,891
OTHER OPERATING EXPENSES:			
Operations and maintenance	13,486,885	13,383,388	12,853,599
General taxes	1,606,421	1,560,386	1,480,746
Depreciation and amortization	5,106,935	4,711,447	4,473,491
Total other operating expenses	20,200,241	19,655,221	18,807,836
OPERATING INCOME	10,006,192	9,681,868	8,795,055
OTHER EXPENSE, net	228,796	206,887	60,117
INTEREST EXPENSE	1,512,419	1,827,001	1,828,099
INCOME BEFORE INCOME TAXES	8,264,977	7,647,980	6,906,839
INCOME TAX EXPENSE	3,170,562	2,939,540	2,644,787
NET INCOME	$ 5,094,415	$ 4,708,440	$ 4,262,052
EARNINGS PER COMMON SHARE:			
Basic	$ 1.08	$ 1.00	$ 0.91
Diluted	$ 1.08	$ 1.00	$ 0.91
WEIGHTED AVERAGE SHARES OUTSTANDING:			
Basic	4,728,210	4,715,478	4,698,727
Diluted	4,731,676	4,716,282	4,698,766

See notes to consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED SEPTEMBER 30, 2015, 2014 AND 2013

	2015	2014	2013
NET INCOME	$ 5,094,415	$ 4,708,440	$ 4,262,052
Other comprehensive income, net of tax:			
Interest rate swaps	—	1,232,546	576,985
Defined benefit plans	(1,147,219)	(220,638)	1,221,866
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	(1,147,219)	1,011,908	1,798,851
COMPREHENSIVE INCOME	$ 3,947,196	$ 5,720,348	$ 6,060,903

See notes to consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED SEPTEMBER 30, 2015, 2014 AND 2013

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance - September 30, 2012	$ 23,352,835	$ 7,375,666	$ 23,904,514	$ (3,950,085)	$ 50,682,930
Net income	—	—	4,262,052	—	4,262,052
Other comprehensive income	—	—	—	1,798,851	1,798,851
Stock option grants	—	84,840	—	—	84,840
Cash dividends declared ($1.72 per share)	—	—	(8,063,327)	—	(8,063,327)
Issuance of common stock (38,759 shares)	193,795	543,281	—	—	737,076
Balance - September 30, 2013	$ 23,546,630	$ 8,003,787	$ 20,103,239	$ (2,151,234)	$ 49,502,422
Net income	—	—	4,708,440	—	4,708,440
Other comprehensive income	—	—	—	1,011,908	1,011,908
Stock option grants	—	75,310	—	—	75,310
Cash dividends declared ($0.74 per share)	—	—	(3,490,624)	—	(3,490,624)
Issuance of common stock (11,052 shares)	55,260	158,131	—	—	213,391
Balance - September 30, 2014	$ 23,601,890	$ 8,237,228	$ 21,321,055	$ (1,139,326)	$ 52,020,847
Net income	—	—	5,094,415	—	5,094,415
Other comprehensive loss	—	—	—	(1,147,219)	(1,147,219)
Exercise of stock options (2,600 shares)	13,000	36,366	—	—	49,366
Stock option grants	—	83,640	—	—	83,640
Cash dividends declared ($0.77 per share)	—	—	(3,643,093)	—	(3,643,093)
Issuance of common stock (18,520 shares)	92,600	290,435	—	—	383,035
Balance - September 30, 2015	$ 23,707,490	$ 8,647,669	$ 22,772,377	$ (2,286,545)	$ 52,840,991

See notes to consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED SEPTEMBER 30, 2015, 2014 AND 2013

	2015	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 5,094,415	$ 4,708,440	$ 4,262,052
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation and amortization	5,219,893	4,838,062	4,656,716
Cost of retirement of utility plant, net	(406,731)	(452,834)	(502,587)
Stock option grants	83,640	75,310	84,840
Deferred taxes and investment tax credits	2,416,841	859,788	786,990
Other noncash items, net	105,815	38,073	39,186
Changes in assets and liabilities which provided (used) cash:			
Accounts receivable and customer deposits, net	638,917	12,424	(374,682)
Inventories and gas in storage	3,168,056	(1,219,641)	(997,378)
Over/under recovery of gas costs	2,082,257	(1,208,134)	1,714,497
Other assets	(768,922)	(306,744)	1,106,590
Accounts payable, customer credit balances and accrued expenses, net	(873,354)	(505,006)	(739,154)
Total adjustments	11,666,412	2,131,298	5,775,018
Net cash provided by operating activities	16,760,827	6,839,738	10,037,070
CASH FLOWS FROM INVESTING ACTIVITIES:			
Expenditures for utility property	(13,780,356)	(14,715,428)	(9,977,433)
Proceeds from disposal of utility property	30,082	16,858	29,923
Net cash used in investing activities	(13,750,274)	(14,698,570)	(9,947,510)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds on collection of notes	—	—	1,142,770
Borrowings under line-of-credit	34,698,924	25,363,774	4,354,402
Repayments under line-of-credit	(34,402,977)	(16,318,724)	(4,354,402)
Proceeds from issuance of unsecured notes	—	30,500,000	—
Retirement of note payable	—	(15,000,000)	—
Retirement of long-term debt	—	(13,000,000)	—
Early termination fees	—	(2,237,961)	—
Debt issuance expenses	—	(193,081)	—
Proceeds from issuance of stock	432,401	213,391	737,076
Cash dividends paid	(3,603,424)	(3,465,034)	(8,033,053)
Net cash provided by (used in) financing activities	(2,875,076)	5,862,365	(6,153,207)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	135,477	(1,996,467)	(6,063,647)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	849,757	2,846,224	8,909,871
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 985,234	$ 849,757	$ 2,846,224
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	$ 1,002,462	$ 1,966,263	$ 1,803,528
Income taxes	1,266,573	2,387,000	622,076

See notes to consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation—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; RGC Ventures of Virginia, Inc., operating as Application Resources and The Utility Consultants; and RGC Midstream, LLC. Roanoke Gas is a natural gas utility, which distributes and sells natural gas to approximately 59,100 residential, commercial and industrial customers within its service areas in Roanoke, Virginia and the surrounding localities. 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. Roanoke Gas is regulated by the Virginia State Corporation Commission ("SCC" or "Virginia Commission"). Application Resources provides information system services to software providers in the utility industry. The Utility Consultants, which provided regulatory consulting services to other utilities, ceased operations in 2015. RGC Midstream, LLC is a new wholly-owned subsidiary created in 2015 to invest in a pipeline project. More information is provided in Note 12. Diversified Energy Company is currently inactive.

The Company follows accounting and reporting standards set by the Financial Accounting Standards Board ("FASB") and the Securities and Exchange Commission ("SEC").

Resources has only one reportable segment as defined under FASB ASC No. 280 – *Segment Reporting*. 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 FASB ASC No. 980, *Regulated Operations*. 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 situation 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). In the event the provisions of FASB ASC No. 980 no longer apply to any or all regulatory assets or liabilities, the Company would write off such amounts and include them in the consolidated statements of income and comprehensive income in the period for which FASB ASC No. 980 no longer applied.

Regulatory assets and liabilities included in the Company's consolidated balance sheets as of September 30, 2015 and 2014 are as follows:

	September 30	
	2015	2014
Regulatory Assets:		
Current Assets:		
Accounts receivable:		
Accrued WNA revenues	$ 229,281	$ 143,753
Under-recovery of gas costs	—	180,831
Other:		
Accrued pension and postretirement medical	530,781	394,215
Utility Property:		
In service:		
Other	11,945	11,945
Other Assets:		
Regulatory assets:		
Premium on early retirement of debt	2,169,556	2,283,744
Accrued pension and postretirement medical	8,378,419	6,884,812
Other	375,268	104,833
Total regulatory assets	$ 11,695,250	$ 10,004,133
Regulatory Liabilities:		
Current Liabilities:		
Over-recovery of gas costs	$ 1,901,426	$ —
Accrued expenses:		
Over-recovery of SAVE Plan revenues	153,365	187,203
Deferred Credits and Other Liabilities:		
Asset retirement obligations	5,295,868	4,802,015
Regulatory cost of retirement obligations	8,885,486	8,575,147
Total regulatory liabilities	$ 16,236,145	$ 13,564,365

As of September 30, 2015, the Company had regulatory assets in the amount of $9,513,749 on which the Company did not earn a return during the recovery period. These assets primarily pertain to the net funded position of the Company's benefit plans related to its regulated operations. As such, the amortization period is not specifically defined.

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 under Asset Retirement Obligations below. Maintenance, repairs, and minor renewals and betterments of property are charged to operations and maintenance.

Utility plant is comprised of the following major classes of assets:

	Years Ended September 30	
	2015	2014
Distribution and transmission	$ 143,172,628	$ 134,439,225
LNG storage	12,501,179	9,163,158
General and miscellaneous	12,359,225	11,757,817
Total utility plant in service	$ 168,033,032	$ 155,360,200

Provisions for depreciation are computed principally at composite straight-line rates as determined by depreciation studies required to be performed on the regulated utility assets of Roanoke Gas Company at least every five years. The

Company completed its most recent depreciation study in June 2014. The composite weighted-average depreciation rates provided for under the new depreciation study were 3.25% for the fiscal years ended September 30, 2015 and 2014 compared to 3.35% for the fiscal year ended September 30, 2013 under the prior rates. For the year ended September 30, 2014, the implementation of the new depreciation rates reduced depreciation expense by $126,875 and increased net income by $78,713 and earnings per share by $0.02.

The composite rates are comprised of two components, one based on average service life and one based on cost of retirement. As a result, the Company accrues the estimated cost of retirement of long-lived assets through depreciation expense. Retirement costs are not a legal obligation but rather the result of cost-based regulation and are accounted for under the provisions of FASB ASC No. 980. Such amounts are classified as a regulatory liability.

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. These reviews have not identified any impairments which would have a material effect on the results of operations or financial condition.

Asset Retirement Obligations—FASB ASC No. 410, *Asset Retirement and Environmental Obligations*, requires entities to record the fair value of a liability for an asset retirement obligation when there exists a legal obligation for the retirement of the asset. 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. The Company has recorded asset retirement obligations for its future legal obligations related to evacuating and capping its distribution mains and services upon retirement, although the timing of such retirements is uncertain.

The Company's composite depreciation rates include a component to provide for the cost of retirement of assets. As a result, the Company accrues the estimated cost of retirement of its utility plant through depreciation expense and creates a corresponding regulatory liability. The costs of retirement considered in the development of the depreciation component include those costs associated with the legal liability. Therefore, the asset retirement obligation is reclassified from the regulatory cost of retirement obligation. If the legal obligations were to 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. In 2015, the Company increased its asset retirement obligation to reflect revisions to the estimated cash flows for asset retirements.

The following is a summary of the asset retirement obligation:

	Years Ended September 30	
	2015	**2014**
Beginning balance	$ 4,802,015	$ 4,525,355
Liabilities incurred	62,890	74,276
Liabilities settled	(162,072)	(165,845)
Accretion	281,762	258,763
Revisions to estimated cash flows	311,273	109,466
Ending balance	$ 5,295,868	$ 4,802,015

Cash, Cash Equivalents and Short-Term Investments—From time to time, the Company will have balances on deposit at banks in excess of the amount insured by the Federal Deposit Insurance Corporation ("FDIC"). The Company has not experienced any losses on these accounts and does not consider these amounts to be at credit risk. As of September 30, 2015, the Company did not have any bank deposits in excess of the FDIC insurance limits. 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.

Customer Receivables and Allowance for Doubtful Accounts—Accounts receivable include amounts billed to customers for natural gas sales and related services and gas sales occurring subsequent to normal billing cycles but before the end of the period. The Company provides an estimate for losses on these receivables by utilizing historical information, current account balances, account aging and current economic conditions. Customer accounts are charged off annually when deemed uncollectible or when turned over to a collection agency for action.

A reconciliation of changes in the allowance for doubtful accounts is as follows:

	Years Ended September 30		
	2015	2014	2013
Beginning balance	$ 70,747	$ 68,539	$ 65,219
Provision for doubtful accounts	87,908	148,881	85,033
Recoveries of accounts written off	139,282	136,369	122,432
Accounts written off	(245,216)	(283,042)	(204,145)
Ending balance	$ 52,721	$ 70,747	$ 68,539

Financing Receivables—Financing receivables represent a contractual right to receive money either on demand or on fixed or determinable dates and are recognized as assets on the entity's balance sheet. Trade receivables are the Company's one primary type of financing receivables, resulting from the sale of natural gas and other services to its customers. These receivable are short-term in nature with a provision for uncollectible balances included in the financial statements.

Inventories—Inventories, consisting of natural gas in storage and materials and supplies, are recorded at average cost. Injections into storage are priced at the purchase cost at the time of injection and withdrawals from storage are priced at the weighted average price in storage. Materials and supplies are removed from inventory at average cost.

Unbilled Revenues—The Company bills its natural gas customers on a monthly cycle; however, the billing cycle period for most customers does not coincide with the accounting periods used for financial reporting. As the Company recognizes revenue when gas is delivered, an accrual is made to estimate revenues for natural gas delivered to customers but not billed during the accounting period. The amounts of unbilled revenue receivable included in accounts receivable on the consolidated balance sheets at September 30, 2015 and 2014 were $1,001,418 and $1,071,128, 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 state and federal consolidated income tax returns.

Debt Expenses—Debt issuance expenses are 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, the SCC provides the Company with a method of passing along to its customers increases or decreases in natural gas costs incurred by its regulated operations, including gains and losses on natural gas derivative hedging instruments. On a quarterly basis, the Company files a PGA rate adjustment request with the SCC to adjust the gas cost component of its rates up or down depending on projected price and activity. Once administrative approval is received, the Company adjusts the gas cost component of its rates to reflect the approved amount. As actual costs will differ from the projections used in establishing the PGA rate, the Company may either over-recover or under-recover its actual gas costs during the period. Any difference between actual costs incurred and costs recovered through the application of the PGA is recorded 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.

Fair Value—Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company determines fair value based on the following fair value hierarchy which prioritizes each input to the valuation methods into one of the following three broad levels:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
- Level 2 – Inputs other than quoted prices in Level 1 that are either for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

- Level 3 – Unobservable inputs for the asset or liability where there is little, if any, market activity which require the Company to develop its own assumptions.

The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3). All fair value disclosures are categorized within one of the three categories in the hierarchy. See fair value disclosures below and in Notes 6 and 10.

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.

Excise and Sales Taxes—Certain excise and sales taxes imposed by the state and local governments in the Company's service territory are collected by the Company from its customers. These taxes are accounted for on a net basis and therefore are not included as revenues in the Company's Consolidated Statements of Income.

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 basic and diluted earnings per share is presented below:

	Years Ended September 30		
	2015	2014	2013
Net Income	$ 5,094,415	$ 4,708,440	$ 4,262,052
Weighted-average common shares	4,728,210	4,715,478	4,698,727
Effect of dilutive securities:			
Options to purchase common stock	3,466	804	39
Diluted average common shares	4,731,676	4,716,282	4,698,766
Earnings Per Share of Common Stock:			
Basic	$ 1.08	$ 1.00	$ 0.91
Diluted	$ 1.08	$ 1.00	$ 0.91

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.

No sales to individual customers accounted for more than 5% of total revenue in any period or amounted to more than 5% of total accounts receivable.

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

Roanoke Gas is served directly by two primary pipelines that provide all of the natural gas supplied to the Company's customers. 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—FASB ASC No. 815, *Derivatives and Hedging*, 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 hedging and derivatives policy allows management to enter into derivatives for the purpose of managing commodity and financial market risks of its business operations. The Company's hedging and derivatives 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 historically has entered 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 as the SCC allows for full recovery of

prudent costs associated with natural gas purchases. At September 30, 2015 and 2014, the Company had no outstanding derivative instruments for the purchase of natural gas.

The Company also had two interest rate swaps that essentially converted its variable interest rate notes to fixed rate debt instruments. Both swaps were terminated in September 2014 as part of the Company's debt refinancing. These swaps qualified as cash flow hedges with changes in fair value reported in other comprehensive income.

No derivative instruments were deemed to be ineffective for any period presented.

Other Comprehensive Income(Loss)—A summary of other comprehensive income is provided below:

	Before Tax Amount	Tax (Expense) or Benefit	Net-of Tax Amount
Year Ended September 30, 2015:			
Defined benefit plans:			
Net loss arising during period	$ (1,910,573)	$ 726,017	$ (1,184,556)
Amortization of actuarial losses	60,221	(22,884)	37,337
Other comprehensive loss	$ (1,850,352)	$ 703,133	$ (1,147,219)
Year Ended September 30, 2014:			
Interest rate swaps:			
Unrealized losses	$ (58,800)	$ 22,321	$ (36,479)
Transfer of realized losses to interest expense	926,262	(351,609)	574,653
Transfer of realized losses to regulatory asset	1,119,233	(424,861)	694,372
Net interest rate swaps	1,986,695	(754,149)	1,232,546
Defined benefit plans:			
Net loss arising during period	(397,714)	151,131	(246,583)
Amortization of actuarial losses	41,846	(15,901)	25,945
Net defined benefit plans	(355,868)	135,230	(220,638)
Other comprehensive income	$ 1,630,827	$ (618,919)	$ 1,011,908
Year Ended September 30, 2013:			
Interest rate swaps:			
Unrealized losses	$ (20,479)	$ 7,774	$ (12,705)
Transfer of realized losses to interest expense	950,501	(360,811)	589,690
Net interest rate swaps	930,022	(353,037)	576,985
Defined benefit plans:			
Net gain arising during period	1,714,890	(651,659)	1,063,231
Amortization of actuarial losses	219,890	(83,558)	136,332
Amortization of transition obligation	35,972	(13,669)	22,303
Net defined benefit plans	1,970,752	(748,886)	1,221,866
Other comprehensive income	$ 2,900,774	$ (1,101,923)	$ 1,798,851

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

Composition of Accumulated Other Comprehensive Income (Loss)

	Interest Rate Swaps	Defined Benefit Plans	Accumulated Other Comprehensive Income (Loss)
Balance September 30, 2012	$ (1,809,531)	$ (2,140,554)	$ (3,950,085)
Other comprehensive income (loss)	576,985	1,221,866	1,798,851
Balance September 30, 2013	(1,232,546)	(918,688)	(2,151,234)
Other comprehensive income (loss)	1,232,546	(220,638)	1,011,908
Balance September 30, 2014	—	(1,139,326)	(1,139,326)
Other comprehensive income (loss)	—	(1,147,219)	(1,147,219)
Balance September 30, 2015	$ —	$ (2,286,545)	$ (2,286,545)

Change in Method of Accounting for Long-term Debt—During the fiscal year ended September 30, 2015, the Company adopted the provisions of ASU 2015-03 as described further under the Recently Adopted Accounting Standards section below. Under ASU 2015-03, the unamortized balance of debt issuance costs are reclassified from assets to liabilities and netted against the carrying value of long-term debt. The change had no impact on net income.

Management retrospectively applied the change. The carrying value of long-term debt and the reclassified debt issuance costs are presented separately on the Company's Consolidated Balance Sheets and in Note 4 for the periods ended September 30, 2015 and 2014.

Recently Adopted Accounting Standards—In June 2011, the FASB issued guidance under FASB ASC No. 220 - *Comprehensive Income* that defines the presentation of Comprehensive Income in the financial statements. According to the guidance, an entity may present a single continuous statement of comprehensive income or two separate statements - a statement of income and a statement of other comprehensive income that immediately follows the statement of income. In either presentation, the entity is required to present on the face of the financial statement the components of other comprehensive income including the reclassification adjustment for items that are reclassified from other comprehensive income to net income. In December 2011, the FASB issued additional guidance under FASB ASC No. 220 that deferred the effective date of earlier guidance with regard to the presentation of reclassifications of items out of accumulated other comprehensive income. All other provisions of the original guidance remain in effect. In February 2013, the FASB issued additional guidance regarding the reporting of amounts reclassified out of accumulated other comprehensive income. Under the new provisions, an entity must present the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income. The disclosures required under this guidance are provided above.

In April 2015, the FASB issued ASU 2015-03, *Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs.* This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The Company previously recognized debt issuance costs in assets and amortized those costs over the term of the debt. This guidance is effective for the Company for the annual reporting period ending September 30, 2017 and interim periods within that annual period. Early application is permitted. The Company adopted the ASU during the current reporting period. The adoption of this ASU did not have an effect on the Company's results of operations or cash flows; however, the unamortized balance of debt issuance costs were reclassified from assets to an offset against long-term debt. Certain deferred costs related to the early retirement of debt in 2014 are classified as regulatory assets and are not offset against debt. The changes required under this guidance are presented in Note 1, Note 4 and the Consolidated Balance Sheets.

Recently Issued Accounting Standards—In May 2014, the FASB issued guidance under FASB ASC No. 606 - *Revenue from Contracts with Customers* that affects any entity that enters into contracts with customers for the transfer of goods or services or transfer of non-financial assets. This guidance supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition,* and most industry-specific guidance. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply these steps: (1) identify the contract with the customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when, or as, the entity satisfies the performance obligation. In August 2015, the FASB issued Accounting Standards Update (ASU) 2015-14 that deferred the effective date of this guidance by one year. Therefore, the new guidance is effective for the Company for the

annual reporting period ended September 30, 2019 and interim periods within that annual period. Early application is not permitted. Management has not completed its evaluation of the new guidance; however, the Company does not currently expect it to have a material effect on its financial position, results of operations or cash flows.

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

2. REGULATORY MATTERS

The SCC exercises regulatory authority over the natural gas operations of Roanoke Gas Company. Such regulation encompasses terms, conditions and rates to be charged to customers for natural gas service, safety standards, service extension, accounting and depreciation.

On September 25, 2015, the Company received approval of its application for a modification to the SAVE (Steps to Advance Virginia's Energy) Plan and Rider. The original SAVE Plan filed in 2012 has been modified each year to incorporate certain changes and to include new projects that qualify for recovery under the Plan. The SAVE Rider provides a mechanism for the Company to recover the related depreciation and expenses and return on rate base of the additional capital investment without the filing of a formal application for an increase in non-gas base rates.

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

3. SHORT-TERM DEBT

The Company has available an unsecured line-of-credit with a bank which will expire March 31, 2016. The Company anticipates being able to extend or replace this line-of-credit upon expiration. The Company's available unsecured line-of-credit varies during the year to accommodate its seasonal borrowing demands. Available limits under this agreement for the remaining term are as follows:

Effective	Available Line-of-Credit
September 30, 2015	$ 24,000,000
March 1, 2016	17,000,000

A summary of the line-of-credit follows:

	September 30		
	2015	2014	2013
Line-of-credit at year-end	$ 24,000,000	$ 15,000,000	$ 5,000,000
Outstanding balance at year-end	9,340,997	9,045,050	—
Highest month-end balance outstanding	17,366,052	9,045,050	1,414,955
Average daily balance	6,377,040	1,340,833	80,593
Average rate of interest during year on outstanding balances	1.17%	1.16%	1.21%
Interest rate at year-end	1.20%	1.16%	1.18%
Interest rate on unused line-of-credit	0.15%	0.15%	0.15%

Associated with the line-of-credit is a credit agreement that contains various provisions including a financial ratio that requires the Company to maintain an interest coverage ratio of not less than 1.5 to 1.

4. LONG-TERM DEBT

Long-term debt consists of the following:

	September 30			
	2015		2014	
	Principal	Unamortized Debt Issuance Costs	Principal	Unamortized Debt Issuance Costs
Unsecured senior notes payable, at 4.26%, due on September 18, 2034	$ 30,500,000	$ 183,427	$ 30,500,000	$ 193,081
Total	$ 30,500,000	$ 183,427	$ 30,500,000	$ 193,081

Debt issuance costs are amortized over the life of the related debt. As of September 30, 2015 and 2014, the Company also had an unamortized loss on the early retirement of debt of $2,169,556 and $2,283,744, respectively, which has been deferred as a regulatory asset and is being amortized over a 20 year period.

The unsecured notes payable contain various provisions, including two financial covenants. First, total long-term debt, including current maturities, shall not exceed 65% of total capitalization. Second, the Company shall not allow priority indebtedness to exceed 15% of total assets.

The aggregate annual maturities of long-term debt for the next five years ending after September 30, 2015 are as follows:

Year Ending September 30	Maturities
2016	$ —
2017	—
2018	—
2019	—
2020	—
Thereafter	30,500,000
Total	$ 30,500,000

5. INCOME TAXES

The details of income tax expense are as follows:

	Years Ended September 30		
	2015	2014	2013
Current income taxes:			
Federal	$ 379,180	$ 1,789,294	$ 1,404,450
State	374,541	290,458	453,347
Total current income taxes	753,721	2,079,752	1,857,797
Deferred income taxes:			
Federal	2,289,729	687,417	829,080
State	127,112	175,464	(33,051)
Total deferred income taxes	2,416,841	862,881	796,029
Amortization of investment tax credits	—	(3,093)	(9,039)
Total income tax expense	$ 3,170,562	$ 2,939,540	$ 2,644,787

Income tax expense for the years ended September 30, 2015, 2014 and 2013 differed from amounts computed by applying the U.S. Federal income tax rate of 34% to earnings before income taxes due to the following:

	Years Ended September 30		
	2015	2014	2013
Income before income taxes	$ 8,264,977	$ 7,647,980	$ 6,906,839
Income tax expense computed at the federal statutory rate	$ 2,810,092	$ 2,600,313	$ 2,348,325
State income taxes, net of federal income tax benefit	331,091	307,509	277,395
Amortization of investment tax credits	—	(3,093)	(9,039)
Other, net	29,379	34,811	28,106
Total income tax expense	$ 3,170,562	$ 2,939,540	$ 2,644,787

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

	September 30	
	2015	2014
Deferred tax assets:		
Allowance for uncollectibles	$ 20,012	$ 26,855
Accrued pension and postretirement medical benefits	2,502,774	2,077,409
Accrued vacation	249,837	230,842
Over-recovery of gas costs	721,782	—
Costs of gas held in storage	930,524	973,651
Accrued gas costs	—	36,305
Deferred compensation	651,336	579,451
Other	265,951	295,654
Total gross deferred tax assets	5,342,216	4,220,167
Deferred tax liabilities:		
Utility plant	19,804,862	17,057,847
Under-recovery of gas costs	—	68,643
Accrued gas costs	157,385	—
Total gross deferred tax liabilities	19,962,247	17,126,490
Net deferred tax liability	$ 14,620,031	$ 12,906,323

Deferred Income Tax - Balance Sheet	September 30	
	2015	2014
Deferred income taxes (net current assets)	$ 2,293,536	$ 1,704,320
Deferred income taxes (net non-current liabilities)	16,913,567	14,610,643
Net deferred tax liability	$ 14,620,031	$ 12,906,323

Current federal tax expense for fiscal 2015 reflected the effect of 50% bonus depreciation for the entire calendar year of 2014, which included nine months of the prior fiscal year. The extension of bonus depreciation for 2014 was signed into law subsequent to the issuance of the Company's financial statements for the year ended September 30, 2014. As a result, $1,442,211 of deferred taxes that related to the prior year were reflected in the current year tax provision, thereby reducing the current tax expense by the same amount. Total income tax expense was not impacted by the classification change between current and deferred income taxes.

FASB ASC No. 740 - *Income Taxes* provides for the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recognized in the financial statements. The Company has evaluated its tax positions and accordingly has not identified any significant uncertain tax positions. The Company's policy is to classify interest associated with uncertain tax positions as interest expense in the financial statements. Penalties are classified under other expense.

The Company files a consolidated federal income tax return and state income tax returns in Virginia and West Virginia. The federal returns and the state returns for both Virginia and West Virginia for the tax years ended prior to September 30, 2012 are no longer subject to examination.

6. EMPLOYEE BENEFIT PLANS

The Company sponsors both a noncontributory defined benefit pension plan and a postretirement benefit plan ("Plans"). The defined benefit pension plan covers substantially all employees and benefits fully vest after 5 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. Employees hired prior to January 1, 2000 are eligible to participate in the postretirement benefit plan. Employees must have a minimum of 10 years of service and retire after attaining the age of 55 in order to vest in the postretirement plan. Retiree contributions to the plan are based on the number of years of service to the Company as determined under the defined benefit plan.

Employers who sponsor defined benefit plans must recognize the funded status of defined benefit pension and other postretirement plans as an asset or liability in its statement of financial position and 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. The regulatory asset is adjusted for the amortization of the transition obligation and recognition of actuarial gains and losses. The portion of the obligation attributable to the unregulated operations of the holding company is recognized in other comprehensive income.

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

	Pension Plan		Postretirement Plan	
	2015	2014	2015	2014
Accumulated benefit obligation	$ 22,853,206	$ 20,697,734	$ 15,355,668	$ 14,983,169
Change in benefit obligation:				
Benefit obligation at beginning of year	$ 24,636,695	$ 21,468,769	$ 14,983,169	$ 13,028,628
Service cost	654,782	553,291	167,580	168,634
Interest cost	1,025,908	1,020,302	600,096	602,684
Actuarial loss	1,487,278	2,199,697	70,196	1,673,552
Benefit payments, net of retiree contributions	(637,042)	(605,364)	(465,373)	(490,329)
Benefit obligation at end of year	$ 27,167,621	$ 24,636,695	$ 15,355,668	$ 14,983,169
Change in fair value of plan assets:				
Fair value of plan assets at beginning of year	$ 20,514,179	$ 18,801,262	$ 10,646,249	$ 10,114,062
Actual return on plan assets, net of taxes	(182,738)	1,750,033	(237,247)	522,516
Employer contributions	1,700,000	568,248	500,000	500,000
Benefit payments, net of retiree contributions	(637,042)	(605,364)	(465,373)	(490,329)
Fair value of plan assets at end of year	$ 21,394,399	$ 20,514,179	$ 10,443,629	$ 10,646,249
Funded status	$ (5,773,222)	$ (4,122,516)	$ (4,912,039)	$ (4,336,920)
Amounts recognized in the balance sheets consist of:				
Noncurrent liabilities	$ (5,773,222)	$ (4,122,516)	$ (4,912,039)	$ (4,336,920)
Amounts recognized in accumulated other comprehensive loss:				
Transition obligation, net of tax	$ —	$ —	$ —	$ —
Net actuarial loss, net of tax	1,694,924	616,352	591,621	522,974
Total amounts included in other comprehensive loss, net of tax	$ 1,694,924	$ 616,352	$ 591,621	$ 522,974
Amounts deferred to a regulatory asset:				
Transition obligation	$ —	$ —	$ —	$ —
Net actuarial loss	5,280,756	4,166,900	3,628,448	3,112,127
Amounts recognized as regulatory assets	$ 5,280,756	$ 4,166,900	$ 3,628,448	$ 3,112,127

Effective with the valuation of the September 30, 2015 defined benefit obligations, the Company adopted the new RP-2014 Mortality Tables as issued by the Society of Actuaries in late 2014. The adoption of the new tables, which reflected an increase in assumed life expectancy, increased the September 30, 2015 pension liability by an estimated $1,300,000 and the postretirement liability by an estimated $1,000,000.

The Company expects that approximately $221,000 before tax, of accumulated other comprehensive loss will be recognized as a portion of net periodic benefit costs in fiscal 2016 and approximately $531,000 of amounts deferred as regulatory assets will be amortized and recognized in net periodic benefit costs in fiscal 2016.

The Company amortized the unrecognized transition obligation over 20 years ending in June 2013.

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 2015, 2014 and 2013.

	Pension Plan			Postretirement Plan		
	2015	2014	2013	2015	2014	2013
Assumptions used to determine benefit obligations:						
Discount rate	4.22%	4.22%	4.82%	4.15%	4.10%	4.73%
Expected rate of compensation increase	4.00%	4.00%	4.00%	N/A	N/A	N/A
Assumptions used to determine benefit costs:						
Discount rate	4.22%	4.82%	4.06%	4.10%	4.73%	3.95%
Expected long-term rate of return on plan assets	7.00%	7.00%	7.25%	4.90%	4.92%	5.11%
Expected rate of compensation increase	4.00%	4.00%	4.00%	N/A	N/A	N/A

To develop the expected long-term rate of return on assets assumption, the Company, with input from the plans' actuaries and investment advisors, 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.

Components of net periodic benefit cost are as follows:

	Pension Plan			Postretirement Plan		
	2015	2014	2013	2015	2014	2013
Service cost	$ 654,782	$ 553,291	$ 634,892	$ 167,580	$ 168,634	$ 213,131
Interest cost	1,025,908	1,020,302	946,247	600,096	602,684	531,845
Expected return on plan assets	(1,440,846)	(1,312,354)	(1,184,787)	(516,656)	(496,476)	(452,383)
Amortization of unrecognized transition obligation	—	—	—	—	—	141,671
Recognized loss	257,378	136,394	578,263	197,058	89,515	241,747
Net periodic benefit cost	$ 497,222	$ 397,633	$ 974,615	$ 448,078	$ 364,357	$ 676,011

The assumed health care cost trend rates used in measuring the accumulated benefit obligation for the postretirement medical plan as of September 30, 2015, 2014 and 2013 are presented below:

	Pre 65			Post 65		
	2015	2014	2013	2015	2014	2013
Health care cost trend rate assumed for next year	8.00%	8.50%	9.00%	5.00%	5.00%	5.00%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2021	2021	2021	2015	2014	2013

The health care cost trend rate assumptions could have a significant effect on the amounts reported. A change of 1% would have the following effects:

	1% Increase	1% Decrease
Effect on total service and interest cost components	$ 137,000	$ (109,000)
Effect on accumulated postretirement benefit obligation	2,383,000	(1,938,000)

The primary objectives of the Plan'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 in both the short-term and long-term. The investment policy provides for a range of investment allocations to allow for flexibility in responding to market conditions. The investment policy is periodically reviewed by the Company and a third-party fiduciary for investment matters.

The Company's target and actual asset allocation in the pension and postretirement benefit plans as of September 30, 2015 and 2014 were:

	Pension Plan			Postretirement Plan		
	Target	2015	2014	Target	2015	2014
Asset category:						
Equity securities	60%	64%	60%	50%	52%	55%
Debt securities	40%	35%	39%	50%	47%	44%
Cash	—%	1%	1%	—%	1%	1%
Other	—%	—%	—%	—%	—%	—%

The assets of the plans are invested in mutual funds. The Company uses the fair value hierarchy described in Note 1 to classify these assets. The mutual funds are included under Level 2 in the fair value hierarchy as their fair values are determined based on individual prices for each security that comprises the mutual funds. Most all of the individual investments are determined based on quoted market prices for each security; however, certain fixed income securities and other investments are not actively traded and are valued based on similar investments. The following table contains the fair value classifications of the benefit plan assets:

		Defined Benefit Pension Plan Fair Value Measurements - September 30, 2015		
	Fair Value	Level 1	Level 2	Level 3
Asset Class:				
Cash	$ 106,502	$ 106,502	$ —	$ —
Common and Collective Trust and Pooled Funds:				
Bonds				
Domestic Fixed Income	3,996,246	—	3,996,246	—
Equities				
Domestic Large Cap Growth	3,150,561	—	3,150,561	—
Domestic Large Cap Value	4,183,172	—	4,183,172	—
Domestic Small/Mid Cap Core	1,937,613	—	1,937,613	—
Foreign Large Cap Value	1,873,313	—	1,873,313	—
Mutual Funds:				
Bonds				
Domestic Fixed Income	3,313,331	—	3,313,331	—
Foreign Fixed Income	213,118	—	213,118	—
Equities				
Domestic Large Cap Growth	1,030,957	—	1,030,957	—
Foreign Large Cap Value	653,276	—	653,276	—
Foreign Large Cap Core	936,310	—	936,310	—
Total	$ 21,394,399	$ 106,502	$ 21,287,897	$ —

	Fair Value	Defined Benefit Pension Plan Fair Value Measurements - September 30, 2014		
		Level 1	Level 2	Level 3
Asset Class:				
Cash	$ 182,644	$ 182,644	$ —	$ —
Common and Collective Trust and Pooled Funds:				
Bonds				
Domestic Fixed Income	1,455,153	—	1,455,153	—
Equities				
Domestic Large Cap Growth	2,079,566	—	2,079,566	—
Domestic Large Cap Value	3,295,144	—	3,295,144	—
Domestic Small/Mid Cap Core	1,850,340	—	1,850,340	—
Foreign Large Cap Value	1,641,619	—	1,641,619	—
Mutual Funds:				
Bonds				
Domestic Fixed Income	6,289,437	—	6,289,437	—
Foreign Fixed Income	204,747	—	204,747	—
Equities				
Domestic Large Cap Growth	2,088,528	—	2,088,528	—
Foreign Large Cap Value	608,787	—	608,787	—
Foreign Large Cap Core	818,214	—	818,214	—
Total	$ 20,514,179	$ 182,644	$ 20,331,535	$ —

	Fair Value	Postretirement Benefit Plan Fair Value Measurements - September 30, 2015		
		Level 1	Level 2	Level 3
Asset Class:				
Cash	$ 58,749	$ 58,749	$ —	$ —
Mutual Funds				
Bonds				
Domestic Fixed Income	4,845,174	—	4,845,174	—
Foreign Fixed Income	38,654	—	38,654	—
Equities				
Domestic Large Cap Growth	1,746,621	—	1,746,621	—
Domestic Large Cap Value	1,638,695	—	1,638,695	—
Domestic Small/Mid Cap Growth	194,260	—	194,260	—
Domestic Small/Mid Cap Value	186,344	—	186,344	—
Domestic Small/Mid Cap Core	417,980	—	417,980	—
Foreign Large Cap Value	893,115	—	893,115	—
Foreign Large Cap Core	378,596	—	378,596	—
Other	45,441	—	45,441	—
Total	$ 10,443,629	$ 58,749	$ 10,384,880	$ —

	Fair Value	Postretirement Benefit Plan Fair Value Measurements - September 30, 2014 Level 1	Level 2	Level 3
Asset Class:				
Cash	$ 116,173	$ 116,173	$ —	$ —
Mutual Funds				
Bonds				
Domestic Fixed Income	4,658,299	—	4,658,299	—
Foreign Fixed Income	101,904	—	101,904	—
Equities				
Domestic Large Cap Growth	1,789,381	—	1,789,381	—
Domestic Large Cap Value	1,759,740	—	1,759,740	—
Domestic Small/Mid Cap Growth	400,898	—	400,898	—
Domestic Small/Mid Cap Value	396,537	—	396,537	—
Domestic Small/Mid Cap Core	37,741	—	37,741	—
Foreign Large Cap Value	941,153	—	941,153	—
Foreign Large Cap Core	394,769	—	394,769	—
Other	49,654	—	49,654	—
Total	$ 10,646,249	$ 116,173	$ 10,530,076	$ —

Each mutual fund has been categorized based on its primary investment strategy.

The Company expects to contribute $500,000 to its pension plan and $500,000 to its postretirement benefit plan in fiscal 2016.

The following table reflects expected future benefit payments:

Fiscal year ending September 30	Pension Plan	Postretirement Plan
2016	$ 655,968	$ 617,386
2017	698,403	625,167
2018	773,580	634,509
2019	818,585	655,095
2020	944,944	695,924
2021-2025	6,531,464	4,012,407

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 401k Plan, limited to a maximum annual amount as set periodically by the Internal Revenue Service. The Company matches 100% of the participant’s first 4% of contributions and 50% on the next 2% of contributions. Company matching contributions were $338,896, $330,241 and $306,382 for 2015, 2014 and 2013, respectively.

7. 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 shares of the Company’s common stock. As of September 30, 2015, the number of shares available for future grants was 49,000.

FASB ASC No. 718 - *Compensation-Stock Compensation* requires that compensation expense be recognized for the issuance of equity instruments to employees. During the fiscal years ended 2015, 2014 and 2013, the Board approved stock option grants to certain officers. As required by the KESOP, each option's exercise price per share equaled the

fair value of the Company's common stock on the grant date. Pursuant to the Plan, the options vest over a six-month period and are exercisable over a ten-year period from the date of issuance.

As the Company's stock options are not traded on the open market, the fair value of each grant is estimated on the date of grant using the Black-Scholes option pricing model including the following assumptions:

	Years Ended September 30,		
	2015	**2014**	**2013**
Expected volatility	34.34%	35.01%	34.75%
Expected dividends	4.11%	4.21%	4.32%
Expected exercise term (years)	7.00	7.00	7.00
Risk-free interest rate	1.98%	2.23%	1.23%

The underlying methods regarding each assumption are as follows:

Expected volatility is based on the historical volatilities of the daily closing price of the Company's common stock.

Expected dividend rate is based on historical dividend payout trends.

Expected exercise term is based on the average time historical option grants were outstanding before being exercised.

Risk-free interest rate is based on the 7-year Treasury rate on the date of option grant.

No ***forfeitures*** are assumed to occur.

Stock option transactions under the Company's plans for the years ended September 30, 2015, 2014 and 2013 are summarized below:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Terms (years)	Aggregate Intrinsic Value [1]
Options outstanding, September 30, 2012	—	$ —	0.0	$ —
Options granted	21,000	19.01		
Options exercised	—	—		
Options expired	—	—		
Options forfeited	—	—		
Options outstanding, September 30, 2013	21,000	19.01	9.5	5,229
Options granted	17,000	18.95		
Options exercised	—	—		
Options expired	—	—		
Options forfeited	—	—		
Options outstanding, September 30, 2014	38,000	18.98	8.8	34,840
Options granted	17,000	21.60		
Options exercised	(2,600)	18.99		
Options expired	—	—		
Options forfeited	—	—		
Options outstanding, September 30, 2015	52,400	$ 19.83	8.3	$ 43,086
Vested and exercisable at September 30, 2015	52,400	$ 19.83	8.3	$ 43,086

[1] Aggregate intrinsic value includes only those options where the exercise price is below the market price.

The weighted-average grant-date fair value of options granted during the years ended September 30, 2015, 2014 and 2013 was $4.92, $4.43 and $4.04, respectively. The intrinsic value of the options exercised during fiscal 2015 was $5,624. The Company recognized $83,640, $75,310 and $84,840 in stock option expense in fiscal 2015, 2014 and 2013, respectively.

The Company received $49,366 from the exercise of options in 2015. No options were exercised in 2013 or 2014.

8. 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 up to $40,000 per year in additional shares of common stock of the Company. Under the DRIP plan, the Company issued 8,431, 7 and 24,905 shares in 2015, 2014 and 2013, respectively. As of September 30, 2015, the Company had 358,377 shares of stock available for issuance under the DRIP Plan.

Restricted Stock Plan

The Board of Directors of the Company implemented the Restricted Stock Plan for Outside Directors ("Plan") effective January 27, 1997. 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 Global Market on the first business day of the month. The Restricted Stock issued under this Plan vests only in the case of a participant's death, disability, retirement, or in the event of a change in control of Resources. The Restricted Stock may not be sold, transferred, assigned or pledged by the participant until the shares have vested under the terms of this Plan. The shares of Restricted Stock will be forfeited to Resources by a participant's voluntary resignation during his or her term on the Board or removal for cause as a director.

The Company assumes all directors will complete their term and there will be no forfeiture of the Restricted Stock. Since the inception of the Plan, no director has forfeited any shares of Restricted Stock. The Company recognizes as compensation the market value of the Restricted Stock in the period it is issued.

The following table reflects the director compensation activity pursuant to the Restricted Stock Plan:

	2015		2014		2013	
	Shares	Weighted-Average Fair Value on Date of Grant	Shares	Weighted-Average Fair Value on Date of Grant	Shares	Weighted-Average Fair Value on Date of Grant
Beginning of year balance	62,844	$ 14.29	59,064	$ 13.97	54,011	$ 13.51
Granted	4,071	20.88	3,780	19.37	5,053	18.93
Vested	—	—	—	—	—	—
Forfeited	—	—	—	—	—	—
End of year balance	66,915	$ 14.70	62,844	$ 14.29	59,064	$ 13.97

The fair market value of the Restricted Stock issued as compensation during fiscal 2015, 2014 and 2013 was $85,000, $73,200 and $95,667. No Restricted Stock vested or was forfeited during fiscal 2015, 2014 and 2013.

As of September 30, 2015, the Company had 70,960 shares available for issuance under the Restricted Stock 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 value of their annual salary. To promote this policy, the Plan provides that all officers with stock ownership positions below 50% of the value of their annual salaries must, unless approved by the Committee, receive no less than 50% of any performance bonus in the form of Company common stock. Shares from the Stock Bonus Plan may also be issued to certain employees and management personnel in recognition of their performance and service. Under the Stock Bonus Plan, the Company issued 2,731, 4,098 and 4,022 shares valued at $59,332, $78,841 and $72,580, respectively, in 2015, 2014 and 2013. As of September 30, 2015 the Company had 8,174 shares of stock available for issuance under the Stock Bonus Plan.

9. COMMITMENTS AND CONTINGENCIES

Long-Term Contracts

Due to the nature of the natural gas distribution business, the Company enters 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 through an asset management contract between Roanoke Gas and a third party asset manager. The Company utilizes an asset manager to optimize the use of its transportation, storage rights, and gas supply inventories which helps to ensure a secure and reliable source of natural gas. Under the current asset management contract, the Company has designated the asset manager to act as agent for the Company's storage capacity and all gas balances in storage. The Company retains ownership of gas in storage. Under provisions of this contract, the Company is obligated to purchase its winter storage requirements from the asset manager during the spring and summer injection periods at market price. The table below details the volumetric obligations as of September 30, 2015 for the remainder of the contract period.

Year	Natural Gas Contracts (In Decatherms)
2015-2016	2,071,061
2016-2017	295,866
Total	2,366,927

The Company also has contracts for pipeline and storage capacity which extend for various periods. These capacity costs and related fees are valued at tariff rates in place as of September 30, 2015. 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 Company expended approximately $33,405,000, $44,884,000 and $35,348,000 under the asset management, pipeline and storage contracts for Roanoke Gas in fiscal years 2015, 2014 and 2013, respectively. The table below details the pipeline and storage capacity obligations as of September 30, 2015 for the remainder of the contract period.

Year	Pipeline and Storage Capacity
2015-2016	$ 11,392,645
2016-2017	9,999,402
2017-2018	7,787,998
2018-2019	6,171,421
2019-2020	2,427,961
Thereafter	—
Total	$ 37,779,427

Other Contracts

The Company maintains other agreements in the ordinary course of business covering various lease, maintenance, equipment and service contracts. These agreements currently extend through December 2031 and are not material to the Company.

Legal

From time to time, the Company may become involved in litigation or claims arising out of its operations in the normal course of business. At the current time, the Company is not known to be a party to any legal proceedings that would be expected to have a materially adverse impact on its financial position, results of operations or cash flows.

Environmental Matters

Both Roanoke Gas Company and a previously owned gas subsidiary operated manufactured gas plants (MGPs) as a source of fuel for lighting and heating until the early 1950's. A by-product of operating MGPs was coal tar, and the potential exists for on-site tar waste contaminants at the former plant sites. While the Company does not currently recognize any commitments or contingencies related to environmental costs at either site, should the Company ever be required to remediate either site, it will pursue all prudent and reasonable means to recover any related costs, including the use of insurance claims and regulatory approval for rate case recognition of expenses associated with any work required.

10. FAIR VALUE MEASUREMENTS

The following table summarizes the Company's financial assets and liabilities that are measured at fair value on a recurring basis and the fair value measurements by level within the fair value hierarchy as defined in Note 1 as of September 30, 2015 and 2014, respectively:

		Fair Value Measurements - September 30, 2015		
	Fair Value	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Liabilities:				
Natural gas purchases	$ 712,710	$ —	$ 712,710	$ —
Total	$ 712,710	$ —	$ 712,710	$ —

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

Under the asset management contract, a timing difference can exist between the payment for natural gas purchases and the actual receipt of such purchases. Payments are made based on a predetermined monthly volume with the price based on the weighted average first of the month index prices corresponding to the month of the scheduled payment. At September 30, 2015 and 2014, the Company had recorded in accounts payable the estimated fair value of the liability determined on the corresponding first of month index prices for which the liability was expected to be settled.

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

The carrying value of cash and cash equivalents, accounts receivable, borrowings under line-of-credit, accounts payable (with the exception of the timing difference under the asset management contract), customer credit balances and customer deposits is a reasonable estimate of fair value due to the short-term nature of these financial instruments. The following table summarizes the fair value of the Company's financial assets and liabilities that are not adjusted to fair value in the financial statements as of September 30, 2015 and 2014.

		Fair Value Measurements - September 30, 2015		
	Carrying Amount	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Liabilities:				
Long-term debt	$ 30,500,000	$ —	$ —	$ 28,570,585
Total	$ 30,500,000	$ —	$ —	$ 28,570,585

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

The fair value of long-term debt is estimated by discounting the future cash flows of the fixed rate debt based on the underlying 20-year Treasury rate and estimated credit spread extrapolated based on market conditions since the issuance of the debt.

FASB ASC 825 – *Financial Instruments* requires disclosures regarding concentrations of credit risk from financial instruments. Cash equivalents are investments in high-grade, short-term securities (original maturity less than three months), placed with financially sound institutions. Accounts receivable are from a diverse group of customers including individuals and small and large companies in various industries. The Company maintains certain credit standards with its customers and requires a customer deposit if such evaluation warrants.

11. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly financial data for the years ended September 30, 2015 and 2014 is summarized as follows:

2015	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Operating revenues	$ 21,250,065	$ 26,431,729	$ 10,774,409	$ 9,733,404
Gross margin	$ 8,622,143	$ 10,213,770	$ 5,961,828	$ 5,408,692
Operating income	$ 3,514,352	$ 4,879,469	$ 956,219	$ 656,152
Net income	$ 1,924,376	$ 2,779,344	$ 354,940	$ 35,755
Earnings per share of common stock:				
Basic	$ 0.41	$ 0.59	$ 0.08	$ 0.01
Diluted	$ 0.41	$ 0.59	$ 0.07	$ 0.01

2014	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Operating revenues	$ 20,011,194	$ 32,699,965	$ 12,024,817	$ 10,280,158
Gross margin	$ 8,202,992	$ 10,161,125	$ 5,721,551	$ 5,251,421
Operating income	$ 3,272,646	$ 5,121,022	$ 940,691	$ 347,509
Net income (loss)	$ 1,722,788	$ 2,846,795	$ 283,194	$ (144,337)
Earnings per share of common stock:				
Basic	$ 0.37	$ 0.60	$ 0.06	$ (0.03)
Diluted	$ 0.37	$ 0.60	$ 0.06	$ (0.03)

12. SUBSEQUENT EVENTS

On October 1, 2015, the Company, through its newly formed wholly-owned subsidiary, RGC Midstream, LLC, entered into an agreement to become a 1% member in the Mountain Valley Pipeline, LLC (the "LLC"). The LLC was established to construct and operate a natural gas pipeline originating in northern West Virginia and extending through south central Virginia. This project, if approved by the Federal Energy Regulatory Commission, will require an estimated $35 million investment by the Company to support the construction of the pipeline over the next 3 years. The projected in service date of the pipeline is late 2018. The Company will participate in the earnings generated from the transportation of natural gas on the pipeline in proportion to its level of investment. The Company will apply the equity method to account for the transactions and activity of the investment.

On October 1, 2015, RGC Midstream borrowed $1,500,000 under a temporary line-of-credit agreement to make its initial investment in the LLC.

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

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