RGC RESOURCES INC
Form 10-Q
August 04, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For Quarterly Period Ended June 30, 2015
Commission File Number 000-26591

RGC Resources, Inc.(Exact name of Registrant as
Specified in its Charter)

VIRGINIA	54-1909697
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
519 Kimball Ave., N.E., Roanoke, VA	24016
(Address of Principal Executive Offices)	(Zip Code)

(540) 777-4427
(Registrant’s Telephone Number, Including Area Code)
None
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated-filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	ý
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Class	Outstanding at July 31, 2015
Common Stock, $5 Par Value	4,731,432

RGC RESOURCES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	Unaudited June 30, 2015	September 30, 2014
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$1,266,213	$849,757
Accounts receivable (less allowance for uncollectibles of $348,408 and $70,747, respectively)	3,556,053	3,730,173
Materials and supplies	1,012,176	893,672
Gas in storage	5,335,529	11,402,990
Prepaid income taxes	—	1,144,214
Deferred income taxes	3,161,870	1,704,320
Under-recovery of gas costs	—	180,831
Other	1,182,310	1,104,660
Total current assets	15,514,151	21,010,617
UTILITY PROPERTY:		
In service	164,130,499	155,360,200
Accumulated depreciation and amortization	(52,618,450)	(50,645,642)
In service, net	111,512,049	104,714,558
Construction work in progress	3,764,040	4,029,019
Utility plant, net	115,276,089	108,743,577
OTHER ASSETS:		
Regulatory assets	9,339,500	9,273,389
Other	347,790	293,139
Total other assets	9,687,290	9,566,528
TOTAL ASSETS	$140,477,530	$139,320,722

See notes to condensed consolidated financial statements.

1

RGC RESOURCES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	Unaudited June 30, 2015	September 30, 2014
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Borrowings under line-of-credit	$1,718,504	$9,045,050
Dividends payable	910,800	873,326
Accounts payable	4,880,132	5,367,299
Customer credit balances	729,287	1,373,927
Income taxes payable	530,386	—
Customer deposits	1,592,838	1,492,150
Accrued expenses	2,050,252	2,200,882
Over-recovery of gas costs	4,329,019	—
Total current liabilities	16,741,218	20,352,634
LONG-TERM DEBT	30,500,000	30,500,000
DEFERRED CREDITS AND OTHER LIABILITIES:		
Asset retirement obligations	4,946,671	4,802,015
Regulatory cost of retirement obligations	9,062,457	8,575,147
Benefit plan liabilities	7,852,590	8,459,436
Deferred income taxes	16,710,509	14,610,643
Total deferred credits and other liabilities	38,572,227	36,447,241
STOCKHOLDERS' EQUITY:		
Common stock, $5 par value; authorized 10,000,000 shares; issued and outstanding 4,730,058 and 4,720,378, respectively	23,650,290	23,601,890
Preferred stock, no par, authorized 5,000,000 shares; no shares issued and outstanding	—	—
Capital in excess of par value	8,475,483	8,237,228
Retained earnings	23,649,618	21,321,055
Accumulated other comprehensive loss	(1,111,306)	(1,139,326)
Total stockholders' equity	54,664,085	52,020,847
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$140,477,530	$139,320,722

RGC RESOURCES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE-MONTH AND NINE-MONTH PERIODS ENDED JUNE 30, 2015 AND 2014
UNAUDITED

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
OPERATING REVENUES:				
Gas utilities	$10,524,512	$11,659,272	$57,591,940	$63,890,166
Other	249,897	365,545	864,263	845,810
Total operating revenues	10,774,409	12,024,817	58,456,203	64,735,976
COST OF SALES:				
Gas utilities	4,698,379	6,112,396	33,229,634	40,214,940
Other	114,202	190,870	428,828	435,368
Total cost of sales	4,812,581	6,303,266	33,658,462	40,650,308
GROSS MARGIN	5,961,828	5,721,551	24,797,741	24,085,668
OTHER OPERATING EXPENSES:				
Operations and maintenance	3,323,533	3,190,706	10,371,812	9,958,196
General taxes	398,447	391,355	1,233,002	1,196,716
Depreciation and amortization	1,283,629	1,198,799	3,842,887	3,596,397
Total other operating expenses	5,005,609	4,780,860	15,447,701	14,751,309
OPERATING INCOME	956,219	940,691	9,350,040	9,334,359
OTHER EXPENSE, Net	21,143	22,043	33,956	92,934
INTEREST EXPENSE	358,850	456,761	1,141,079	1,376,871
INCOME BEFORE INCOME TAXES	576,226	461,887	8,175,005	7,864,554
INCOME TAX EXPENSE	221,286	178,693	3,116,345	3,011,777
NET INCOME	$354,940	$283,194	$5,058,660	$4,852,777
BASIC EARNINGS PER COMMON SHARE	$0.08	$0.06	$1.07	$1.03
DILUTED EARNINGS PER COMMON SHARE	$0.07	$0.06	$1.07	$1.03
DIVIDENDS DECLARED PER COMMON SHARE	$0.1925	$0.1850	$0.5775	$0.5550

See notes to condensed consolidated financial statements.

3

RGC RESOURCES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE-MONTH AND NINE-MONTH PERIODS ENDED JUNE 30, 2015 AND 2014
UNAUDITED

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
NET INCOME	$354,940	$283,194	$5,058,660	$4,852,777
Other comprehensive income, net of tax:				
Interest rate SWAPs	—	133,472	—	400,135
Defined benefit plans	9,340	6,490	28,020	19,470
OTHER COMPREHENSIVE INCOME, NET OF TAX	9,340	139,962	28,020	419,605
COMPREHENSIVE INCOME	$364,280	$423,156	$5,086,680	$5,272,382

See notes to condensed consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE-MONTH PERIODS ENDED JUNE 30, 2015 AND 2014
UNAUDITED

	Nine Months Ended June 30, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$5,058,660	$4,852,777
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,927,080	3,741,781
Cost of removal of utility plant, net	(284,298)	(328,744)
Stock option grants	83,640	75,310
Changes in assets and liabilities which used cash, exclusive of changes and noncash transactions shown separately	11,402,734	3,968,568
Net cash provided by operating activities	20,187,816	12,309,692
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to utility plant and nonutility property	(9,989,394)	(10,781,425)
Proceeds from disposal of equipment	27,724	9,322
Net cash used in investing activities	(9,961,670)	(10,772,103)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under line-of-credit agreement	23,471,147	13,893,656
Repayments under line-of-credit agreement	(30,797,693)	(13,893,656)
Proceeds from issuance of stock (9,680 and 9,324 shares, respectively)	209,479	179,166
Cash dividends paid	(2,692,623)	(2,592,025)
Net cash used in financing activities	(9,809,690)	(2,412,859)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	416,456	(875,270)
BEGINNING CASH AND CASH EQUIVALENTS	849,757	2,846,224
ENDING CASH AND CASH EQUIVALENTS	$1,266,213	$1,970,954
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$992,997	$1,503,380
Income taxes paid	816,573	1,686,000

See notes to condensed consolidated financial statements.

RGC RESOURCES, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED

1. Basis of Presentation

RGC Resources, Inc. is an energy services company primarily engaged in the sale and distribution of natural gas. The consolidated financial statements include the accounts of RGC Resources, Inc. ("Resources" or the "Company") and its wholly owned subsidiaries: Roanoke Gas Company; Diversified Energy Company; and RGC Ventures of Virginia, Inc.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly Resources financial position as of June 30, 2015 and the results of its operations, cash flows and comprehensive income for the three months and nine months ended June 30, 2015 and 2014. The results of operations for the three months and nine months ended June 30, 2015 are not indicative of the results to be expected for the fiscal year ending September 30, 2015 as quarterly earnings are affected by the highly seasonal nature of the business and weather conditions generally result in greater earnings during the winter months.

The unaudited condensed consolidated interim financial statements and condensed notes are presented as permitted under the rules and regulations of the Securities and Exchange Commission. Pursuant to those rules, certain information and note disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, although the Company believes that the disclosures made are adequate to make the information not misleading. Therefore, the condensed consolidated financial statements and condensed notes should be read in conjunction with the financial statements and notes contained in the Company’s Form 10-K for the year ended September 30, 2014. The September 30, 2014 balance sheet was included in the Company’s audited financial statements included in Form 10-K.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company’s significant accounting policies are described in Note 1 to the consolidated financial statements in Form 10-K for the year ended September 30, 2014. Newly adopted and newly issued accounting standards are discussed below.

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 the following 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. The new guidance is effective for the Company for the annual reporting period ending September 30, 2018 and interim periods within that annual period. Early application is not permitted. In March 2015, the FASB issued an exposure draft to provide for a one-year deferral of the effective date of the new revenue standard. If approved, the new guidance would be effective for the Company for the annual reporting period ending September 30, 2019 and interim periods within that year. Management has not completed its evaluation of the new guidance. However, the Company does not currently expect the new guidance to have a material effect on its financial position, results of operations or cash flows.

In April 2015, the FASB issued Accounting Standards Update (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 currently recognizes debt issuance costs in assets and amortizes 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 anticipates adopting the ASU in the current fiscal year. The adoption of this ASU is not expected to have an effect on the Company's results of operations or cash flows; however, the unamortized balance of debt issuance costs will be reclassified from assets to an offset against long-term debt. The deferred costs related to early retirement of debt are currently classified as assets and will not be offset against debt when the ASU is adopted.

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

2. Rates and Regulatory Matters

The State Corporation Commission of Virginia ("SCC") exercises regulatory authority over the natural gas operations of Roanoke Gas. Such regulation encompasses terms, conditions, and rates to be charged to customers for natural gas service; safety standards; extension of service; and accounting and depreciation.

On 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 debt 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 authorization extends through September 30, 2019.

On June 30, 2015, the Company filed with the SCC an application for a modification to the SAVE (Steps to Advance Virginia's Energy) Plan and Rider. The original SAVE Plan has been modified each year to incorporate certain changes and to include new projects that qualify for rate recovery under the Plan. Under this application, the Company submitted its report for refunding the excess SAVE revenues collected under the 2014 SAVE Plan and proposed new SAVE rates to be implemented for the ongoing investment in SAVE Plan projects. The Company anticipates the SCC to complete its review of the application over the next few months.

3. Short-Term Debt

The Company entered into a new unsecured line-of-credit agreement dated March 31, 2015. The new agreement maintains the same variable interest rate based on 30-day LIBOR plus 100 basis points and availability fee of 15 basis points as the prior agreement. The agreement also includes multi-tiered borrowing limits to accommodate seasonal borrowing demands and minimize borrowing costs. The Company's total available borrowing limits during the term of the new line-of-credit agreement range from $6,000,000 to $24,000,000. The line-of-credit agreement will expire March 31, 2016, unless extended. The Company anticipates being able to extend or replace the credit line upon expiration. As of June 30, 2015, the Company had $1,718,504 outstanding under its line-of-credit agreement.

4. Derivatives and Hedging

The Company's risk management policy allows management to enter into derivatives for the purpose of managing the commodity and financial market risks of its business operations. The Company's risk management policy specifically prohibits the use of derivatives for speculative purposes. The key market risks that the Company seeks to hedge include the price of natural gas and the cost of borrowed funds.

The Company previously had two interest rate swaps associated with its variable rate notes. These swaps were terminated when the Company refinanced the corresponding notes on September 18, 2014. The Company has no derivative instruments outstanding at June 30, 2015.

5. Other Comprehensive Income

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

RGC RESOURCES, INC. AND SUBSIDIARIES

	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount
Three Months Ended June 30, 2015			
Defined benefit plans:			
Amortization of actuarial losses	$15,055	$(5,715)	$9,340
Other comprehensive income	$15,055	$(5,715)	$9,340
Three Months Ended June 30, 2014			
Interest rate swaps:			
Unrealized losses	$(24,711)	$9,380	$(15,331)
Transfer of realized losses to interest expense	239,850	(91,047)	148,803
Net interest rate SWAPs	215,139	(81,667)	133,472
Defined benefit plans:			
Amortization of actuarial losses	10,461	(3,971)	6,490
Other comprehensive income	$225,600	$(85,638)	$139,962

	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount
Nine Months Ended June 30, 2015			
Defined benefit plans:			
Amortization of actuarial losses	$45,165	$(17,145)	$28,020
Other comprehensive income	$45,165	$(17,145)	$28,020
Nine Months Ended June 30, 2014			
Interest rate swaps:			
Unrealized losses	$(73,630)	$27,950	$(45,680)
Transfer of realized losses to interest expense	718,592	(272,777)	445,815
Net interest rate SWAPs	644,962	(244,827)	400,135
Defined benefit plans:			
Amortization of actuarial losses	31,383	(11,913)	19,470
Other comprehensive income	$676,345	$(256,740)	$419,605

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

Reconciliation of Other Accumulated Comprehensive Income (Loss)

	Accumulated Other Comprehensive Income (Loss)
Balance at September 30, 2014	$(1,139,326)
Other comprehensive income	28,020
Balance at June 30, 2015	$(1,111,306)

6. Earnings Per Share

Basic earnings per common share for the three months and nine months ended June 30, 2015 and 2014 were calculated by dividing net income by the weighted average common shares outstanding during the period. Diluted earnings per common share were calculated by dividing net income by the weighted average common shares outstanding during the period plus potential dilutive common shares. A reconciliation of basic and diluted earnings per share is presented below:

RGC RESOURCES, INC. AND SUBSIDIARIES

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
Net Income	$354,940	$283,194	$5,058,660	$4,852,777
Weighted average common shares	4,729,428	4,718,068	4,725,144	4,714,023
Effect of dilutive securities:				
Options to purchase common stock	3,192	830	3,814	432
Diluted average common shares	4,732,620	4,718,898	4,728,958	4,714,455
Earnings Per Share of Common Stock:				
Basic	$0.08	$0.06	$1.07	$1.03
Diluted	$0.07	$0.06	$1.07	$1.03

7. Commitments and Contingencies

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

Due to the nature of the natural gas distribution business, the Company has entered into agreements with both suppliers and pipelines for natural gas commodity purchases, storage capacity and pipeline delivery capacity. The Company obtains most of its regulated natural gas supply from an asset manager. The Company uses an asset manager to assist in optimizing the use of its transportation, storage rights, and gas supply in order to provide a secure and reliable source of natural gas to its customers. The Company also has storage and pipeline capacity contracts to store and deliver natural gas to the Company’s distribution system. Roanoke Gas is served directly by two primary pipelines. These two pipelines deliver all of the natural gas supplied to the Company’s customers. Depending on weather conditions and the level of customer demand, failure of one or both of these transmission pipelines could have a major adverse impact on the Company.

8. Employee Benefit Plans

The Company has both a defined benefit pension plan (the “pension plan”) and a postretirement benefit plan (the “postretirement plan”). The pension plan covers substantially all of the Company’s employees and provides retirement income based on years of service and employee compensation. The postretirement plan provides certain health care and supplemental life insurance benefits to retired employees who meet specific age and service requirements. Net pension plan and postretirement plan expense recorded by the Company is detailed as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
Components of net periodic pension cost:				
Service cost	$163,696	$138,323	$491,088	$414,969
Interest cost	256,477	255,076	769,431	765,228
Expected return on plan assets	(360,212)	(328,089)	(1,080,636)	(984,267)
Recognized loss	64,345	34,099	193,035	102,297
Net periodic pension cost	$124,306	$99,409	$372,918	$298,227

RGC RESOURCES, INC. AND SUBSIDIARIES

	Three Months Ended June 30, 2015	2014	Nine Months Ended June 30, 2015	2014
Components of postretirement benefit cost:				
Service cost	$41,895	$42,159	$125,685	$126,477
Interest cost	150,024	150,671	450,072	452,013
Expected return on plan assets	(129,164)	(124,119)	(387,492)	(372,357)
Recognized loss	49,265	22,379	147,795	67,137
Net postretirement benefit cost	$112,020	$91,090	$336,060	$273,270

The Company contributed $600,000 to its pension plan and $375,000 to its postretirement medical plan during the nine-month period ended June 30, 2015. The Company currently expects to contribute at least an additional $200,000 to its pension plan and $125,000 to its postretirement benefit plan prior to the end of its fiscal year.

9. Fair Value Measurements

FASB ASC No. 820, Fair Value Measurements and Disclosures, established a fair value hierarchy that prioritizes each input to the valuation method used to measure fair value of financial and nonfinancial assets and liabilities that are measured and reported on a fair value basis into one of the following three broad levels:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 – Inputs other than quoted prices in Level 1 that are either for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Unobservable inputs for the asset or liability where there is little, if any, market activity for the asset or liability at the measurement date.

The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3).

The following table summarizes the Company’s financial assets and liabilities that are measured at fair value on a recurring basis as required by existing guidance and the fair value measurements by level within the fair value hierarchy as of June 30, 2015 and September 30, 2014:

		Fair Value Measurements - June 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	$1,297,634	$—	$1,297,634	$—