RGC RESOURCES INC
Form ARS
December 21, 2004

Exhibit 13

RGC RESOURCES *PROVIDES SUPERIOR CUSTOMER AND SHAREHOLDER VALUE AS A PREFERRED PROVIDER OF ENERGY AND DIVERSIFIED PRODUCTS AND SERVICES IN ITS SELECTED MARKET AREAS.*

Virginia is one of the top apple-producing states in the nation, growing 11 varieties throughout the region.

FINANCIAL HIGHLIGHTS

Years Ended September 30,	2004	2003	2002
Operating Revenue - Natural Gas	**$ 83,703,964**	$ 75,321,337	$ 57,647,947
Energy Marketing Revenue	**$ 18,810,525**	$ 13,091,137	$ 11,107,532
Other Revenue	**$ 632,575**	$ 421,479	$ 555,639
Net Income - Continuing Operations	**$ 2,066,802**	$ 1,998,779	$ 1,936,156
Net Income - Discontinued Operations	**$ 10,867,211**	$ 1,529,610	$ 550,739
Basic Earnings Per Share - Continuing Operations	**$ 1.02**	$ 1.01	$ 1.00
Basic Earnings Per Share - Discontinued Operations	**$ 5.36***	$ 0.77	$ 0.28
Regular Dividend Per Share - Cash	**$ 1.17**	$ 1.14	$ 1.14
Number of Customers - Natural Gas	**58,081**	57,691	57,229
Total Natural Gas Deliveries - DTH	**11,903,920**	12,041,193	10,563,514
Total Additions to plant	**$ 7,925,948**	$ 6,774,991	$ 6,581,060

* Reflects $4.69 gain on sale of assets.

TO OUR SHAREHOLDERS

We took advantage of that convergence of forces to secure what we believe was the maximum potential value for our propane assets.

I am pleased to report company earnings of $12.9 million, $9.5 million of gain on the sale of propane assets and $3.4 million from company operations. This indicates per share earnings of $4.69 from the asset sale and $1.69 from operations. I am also pleased to report that we distributed $4.50 of the gain on the sale and $1.17 of the earnings on operations to our shareholders. The total cash dividend of $5.67 paid to shareholders in 2004 represents a 25% return on the January 2, 2004 share closing price of $22.60.

After having worked for over a decade to grow our propane distribution business, reaching the strategic decision to sell propane assets was a very deliberative process. I have long believed that the market price of our stock did not adequately reflect the value of our propane operation. We concluded the only way to allow shareholders to fully realize the hidden propane value was through a carefully researched and competitively negotiated transaction. The $4.50 special dividend reflects our success in extracting and providing that hidden value for our shareholders. The timing of the transaction was critically important. A low interest rate environment, a recovering economy, and a peaking desire by the national propane consolidators to acquire assets, combined with the strong market position of our propane operation, created a premium selling opportunity. We took advantage of that convergence of forces to secure what we believe was the maximum potential value for our propane assets. We also timed the transaction to be able to distribute the special dividend to shareholders, while we were certain the 15% federal income tax rate on common stock dividends for individuals would still be in place. In addition to distributing $9.3 million to

NATURAL ADVANTAGE

shareholders from proceeds of the sale, we retired debt of $4.2 million and invested $3 million in natural gas operations. We anticipate investing additional proceeds from the sale in our natural gas distribution system to replace the earnings from our former propane investments.

Our near term focus is on growing and enhancing our natural gas distribution systems while looking for opportunities to develop and offer energy and utility related products and services that are a fit with our systems.

Our near term focus is on growing and enhancing our natural gas distribution systems while looking for opportunities to develop and offer energy and utility related products and services that are a fit with our systems and core competencies. In furtherance of that focus and strategy, we invested $7.9 million in natural gas distribution system capital improvements in 2004. We completed our reinforcement program on the ten-inch natural gas distribution main serving Bluefield Gas Company, and we added a section of twelve-inch pipeline to reinforce the Roanoke Gas system eastern loop. We also replaced eight miles of older cast iron and bare steel mains with new plastic or coated steel pipe to enhance deliverability and safety and to lower repair and maintenance costs. We expect to continue the cast iron and bare steel pipe replacement program.

We also installed twelve miles of new distribution mains and over 1,200 new service lines to extend gas service to new commercial and residential customers. As a result of the economic recovery and continued low interest rates, new home construction in the Roanoke area has remained robust and builders and homeowners are continuing to choose natural gas service where it is available. The short-term pricing volatility of natural gas has continued to increase; consequently, we are focusing our marketing efforts on the comfort, reliability, and environmental advantages of using natural gas and on maintaining close working relationships with developers, home builders and heating and plumbing contractors who frequently determine or heavily influence energy use decisions.

RELIABLE SUPPLY

In spite of record high energy prices, and the obvious environmental and security advantages of natural gas, Congress continues to be unable or unwilling to adopt comprehensive energy legislation designed to encourage natural gas exploration, alternative fuels development, and energy conservation. The November 1, 2004 closing price per decatherm of natural gas at the Henry Hub was $9.39, compared to $5.13 in 2003 and $4.06 in 2002. Likewise, the cost of a barrel of crude oil on the New York Mercantile Exchange on November 1, 2004 was $50.13, compared to $29.11 in 2003 and $27.13 in 2002. The certainty of an adequate and reliable energy supply for the United States, combined with programs to promote conservation, needs to be a federal priority. If there is not an adequate supply response to the current situation, facilitated by timely accesses to additional areas for exploration, there will be a demand response, and the implications for the United States economy are not likely to be favorable. I encourage you to join me in contacting members of Congress to urge passage of comprehensive energy legislation.

We believe we have adequate gas supplies to meet our 2005 winter demand based on gas already in storage combined with our supply contracts.

We believe we have adequate gas supplies to meet our 2005 winter demand based on gas already in storage combined with our supply contracts. We recently renewed our interstate pipeline and natural gas storage capacity contracts on the Columbia Gas Transmission system through the year 2014 and our other pipeline and storage capacity contracts remain in place with renewal dates ranging from 2008 through 2014.

We continue to work toward full implementation of Sarbanes-Oxley, Section 404 federal requirements for fiscal year 2005. The additional accounting and internal controls provisions are both expensive and demanding of human resources. In fact, the projected added cost and administrative burden of Section 404 compliance was also a contributing factor in our decision to sell the propane operation prior to having to absorb the increased cost into a very price competitive line of business.

SOLID RETURNS

Fiscal year 2005 will be a transitional year for RGC Resources. In addition to being the year for full compliance with Sarbanes-Oxley Section 404, it will be our first year without the propane operation, although we continue to provide computer and billing services and leased facilities to the purchaser of the propane assets. It will also be the year that we say good-bye to two long serving and highly valuable members of our Board of Directors. Lynn D. Avis, Chairman of Avis Construction and Thomas L. Robertson, former President and CEO of the Carilion Health System will both retire from the Board in January 2005. They joined the Board of Roanoke Gas Company in 1986 and were founding members of the RGC Resources, Inc. Board of Directors in 1999. We will miss their wisdom, experience and support. However, I am pleased and honored to announce that Nancy H. Agee, Executive Vice President and Chief Operating Officer of Carilion Health System and Raymond D. Smoot, Jr., Chief Operating Officer and Secretary-Treasurer of Virginia Tech Foundation, Inc. have agreed to join the Board. They are on the proxy ballot for approval at our January 24, 2005 annual shareholders meeting.

I remain confident in our ability to provide safe and reliable service for our customers, a supportive, engaging, and learning environment for our employees and a solid return for our shareholders.

As I have stated in the past, it continues to be an exciting time to lead a publicly traded company in the energy distribution business. The added regulatory burdens of Sarbanes-Oxley and volatile energy prices create unique challenges, but I remain confident in our ability to provide safe and reliable service for our customers, a supportive, engaging, and learning environment for our employees and a solid return for our shareholders.

I thank you for your continuing investment and interest in RGC Resources, Inc.

Sincerely,

JOHN B. WILLIAMSON, III

Chairman, President and CEO

SELECTED FINANCIAL DATA

Years Ended September 30,	**2004**	**2003**	**2002**	**2001**	**2000**
Operating Revenues	**$ 103,147,064**	$ 88,833,953	$ 69,311,118	$ 102,397,478	$ 66,384,578
Gross Margin	**23,392,664**	21,918,225	19,522,244	21,869,388	20,603,047
Operating Income	**5,194,107**	5,283,862	4,978,003	4,647,832	5,162,295
Net Income - Continuing Operations	**2,066,802**	1,998,779	1,936,156	1,302,024	2,082,472
Net Income - Discontinued Operations	**10,867,211**	1,529,610	550,739	1,004,591	791,230
Basic Earnings Per Share - Continuing Operations	**$ 1.02**	$ 1.01	$ 1.00	$ 0.68**	$ 1.12
Basic Earnings Per Share - Discontinued Operations	**5.36***	$ 0.77	$ 0.28	$ 0.53	$ 0.42
Cash Dividends Declared Per Share	**$ 5.67**	$ 1.14	$ 1.14	$ 1.12	$ 1.10
Book Value Per Share	**17.73**	16.90	16.36	16.05	15.94
Average Shares Outstanding	**2,027,908**	1,983,970	1,939,511	1,898,697	1,863,275
Total Assets	**114,972,556**	104,364,733	96,978,115	97,324,955	90,451,800
Long-Term Debt (Less Current Portion)	**26,000,000**	30,219,987	30,377,358	22,507,485	23,310,522
Stockholders Equity	**36,621,522**	33,857,614	32,068,997	30,725,072	29,985,871
Shares Outstanding at Sept. 30	**2,065,408**	2,003,232	1,960,418	1,914,603	1,881,733

* Reflects $4.69 gain on sale of assets.

** Reflects $.32 per share impairment loss.

FORWARD-LOOKING STATEMENTS

From time to time, RGC Resources, Inc. (Resources or the Company) may publish forward-looking statements relating to such matters as anticipated financial performance, business prospects, technological developments, new products, research and development activities and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors could cause the Company s actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company s forward-looking statements. The risks and uncertainties that may affect the operations, performance, development and results of the Company s business include the following: (i) failure to earn on a consistent basis an adequate return on invested capital; (ii) increasing expenses and labor costs and labor availability; (iii) price competition from alternative fuels; (iv) volatility in the price and availability of natural gas; (v) uncertainty in the projected rate of growth of natural gas requirements in the Company s service area; (vi) general economic conditions both locally and nationally; (vii) increases in interest rates; (viii) increased customer delinquencies and conservation efforts resulting from high fuel costs and/or colder weather; (ix) developments in electricity and natural gas deregulation and associated industry restructuring; (x) variations in winter heating degree-days from normal; (xi) changes in environmental requirements, pipeline operating requirements and cost of compliance; (xii) impact of potential increased governmental oversight and compliance costs due to the Sarbanes-Oxley law; (xiii) failure to obtain timely rate relief for increasing operating or gas costs from regulatory authorities; (xiv) ability to raise debt or equity capital; (xv) impact of uncertainties in the Middle East and related terrorism issues, and (xvi) new accounting standards issued by the Financial Accounting Standards Board, which could change the accounting treatment for certain transactions. All of these factors are difficult to predict and many are beyond the Company s control. Accordingly, while the Company believes its forward-looking statements to be reasonable, there can be no assurance that they will approximate actual experience or that the expectations derived from them will be realized. When used in the Company s documents or news releases, the words, anticipate, believe, intend, plan, estimate, expect, objective, projection, forecast or similar words or future or conditional verbs such as will, would, should, are intended to identify forward-looking statements.

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

MANAGEMENT S DISCUSSION & ANALYSIS

GENERAL

Resources is an energy services company primarily engaged in the regulated sale and distribution of natural gas to approximately 58,000 residential, commercial and industrial customers in Roanoke, Virginia and Bluefield, Virginia and West Virginia and the surrounding areas through its Roanoke Gas Company and Bluefield Gas Company subsidiaries. Natural gas service is provided at rates and for the terms and conditions set forth by the State Corporation Commission (SCC) in Virginia and the Public Service Commission (PSC) in West Virginia. Roanoke Gas and Bluefield Gas currently hold the only franchises and/or certificates of public convenience and necessity to distribute natural gas in its Virginia and West Virginia service areas. These franchises are effective through January 1, 2016 in Virginia and August 23, 2009 in West Virginia. While there are no assurances, the Company believes that it will be able to negotiate acceptable franchises when the current agreements expire. Certificates of public convenience and necessity in Virginia are exclusive and are intended to be of perpetual duration.

Resources also provides unregulated energy products through Diversified Energy Company, which operates as Highland Energy Company. Highland Energy brokers natural gas to numerous industrial and commercial transportation customers of Roanoke Gas Company and Bluefield Gas Company. Although the energy marketing operations do not fall under the jurisdiction of the SCC and PSC, they are subject to or affected by various federal and state regulations. Prices are determined by the Company and are subject to market demands and price competition. In addition to an energy marketing company, Diversified Energy Company operated an unregulated propane operation under the name of Highland Propane Company. In July 2004, RGC Resources, Inc. sold the propane operations. These operations as such have been classified as discontinued operations in the financial statements. Please see the Discontinued Operations section below for further discussion.

RGC Resources, Inc. also provides information system services to software providers in the utility industry through RGC Ventures, Inc. of Virginia, which operates as Application Resources.

Management views warm winter weather, energy conservation, fuel switching and bad debts due to high energy prices, and competition from alternative fuels each as factors that could have a significant impact on the Company s earnings. In addition, management has concerns regarding the cost and time required for complying in the future with the regulations regarding internal controls promulgated pursuant to Section 404 of the Sarbanes-Oxley Act of 2002.

For the fiscal year ended September 30, 2004, the Company experienced a decline in sales volumes due to warmer winter weather. The effect of the warmer weather on the results of operations was mitigated due to the non-gas rate increase placed into effect in October 2003.

RESULTS OF OPERATIONS CONTINUING-OPERATIONS

FISCAL YEAR 2004 COMPARED WITH FISCAL YEAR 2003

OPERATING REVENUES - Total operating revenue increased $14,313,111, or 16%, for the year ended September 30, 2004 (fiscal 2004) compared to the year ended September 30, 2003 (fiscal 2003). The increase in revenues resulted from a combination of higher natural gas costs and increased sales volumes in the energy marketing operations. The average per unit cost of natural gas increased by 22% for regulated operations and 13% for energy marketing operations over last year.

GROSS MARGIN - Total gross margin increased $1,474,439, or 6.7%, for fiscal 2004 compared to fiscal 2003.

Year Ended September 30,	2004	2003	Increase/ (Decrease)	Percentage
Gross Margin:				
Gas Utilities	**$ 22,833,506**	$ 21,425,681	$ 1,407,825	6.6%
Energy Marketing	**254,716**	285,042	(30,326)	-10.6%
Other	**304,442**	207,502	96,940	46.7%
Total Gross Margin	**$ 23,392,664**	$ 21,918,225	$ 1,474,439	6.7%

Regulated natural gas margins increased $1,407,825, or 6.6%, as total delivered volumes decreased by 1% due to significantly warmer winter weather. Tariff sales, composed mainly of weather sensitive residential and commercial volumes, declined by 7.6%. This decline in tariff sales primarily resulted from a 10% decline in heating degree days (an industry measure by which the average daily temperature falls below 65 degrees Fahrenheit) from the same period last year. Furthermore, total heating degree days for fiscal 2004 were 7% below the 30 year normal. Transportation services, consisting of delivered volumes of natural gas purchased from other than the regulated utilities, and generally correlated more with economic conditions, increased 19.4 %, reflecting continued improvement in the economy and industrial production. Even though high natural gas prices do not appear to have had a discernable effect on demand for natural gas and gas transportation service, continued high prices could result in some customers seeking lower-cost alternative fuel sources depending upon the price of natural gas compared to other energy sources.

Although the volume of natural gas tariff sales declined by 7.6%, regulated natural gas margins increased due to Commission approved non-gas cost rate increases placed into effect on October 16, 2003 by Roanoke Gas Company and December 1, 2003 by Bluefield Gas Company. The total annual non-gas cost rate increase associated with the approved rate increases amounted to approximately $1,650,000 based upon a normal weather year. As a result of these higher rates, customer base charges, in the form of a flat monthly fee billed to each natural gas customer, rose $642,295 and volumetric margin increased $765,530.

Energy marketing margins decreased $30,326, or 10.6%, from last year, even though total delivered volumes increased by 656,876 DTH, or 28.5%. The increase in sales volume was attributable to a combination of improving economic conditions and sales to two additional customers of the marketing operations. The new customers accounted for approximately 37% of the increased volume. The decline in unit margin (margin per dekatherm) is reflective of an average 13% increase in energy prices and competitive conditions.

NATURAL FACT:

Natural gas has increasingly become the fuel of choice by both the environmental community and industry as an acceptable alternative in the transition away from coal nuclear power and hydro electric power.

Other margins increased by $96,940, or 46.7%, over the same period last year due to billings for the fuel line protection program, a new service program which contributed approximately $65,000 to other margins, and net fees earned in connection with the services and facilities provided to the purchaser of the Company s propane operations subsequent to its sale.

Year Ended September 30,	2004	2003	Increase/ (Decrease)	Percentage
Regulated Natural Gas -				
DTH Tariff Sales	8,466,916	9,162,397	(695,481)	-7.6%
Transportation Volumes	**3,437,004**	2,878,796	558,208	19.4%
Total Delivered Volume (DTH)	**11,903,920**	12,041,193	(137,273)	-1.1%
Highland Energy (DTH)	**2,957,962**	2,301,086	656,876	28.5%
Heating Degree Days (Unofficial)	**3,917**	4,349	(432)	-9.9%

OTHER OPERATING EXPENSES - Operations expenses increased $1,122,254, or 11.3%, in fiscal 2004 compared with fiscal 2003. The increased operations expenses related to higher employee compensation and benefit costs, corporate insurance, professional services and debt retirement costs partially offset by reduced bad debt expense and greater capitalization of overheads. Employee benefit costs increased $194,782 primarily due to higher pension costs related to a reduction in the actuarial discount rate assumption and amortization of actuarial losses related to the investment performance of plan assets over the past few years. Total labor expense increased $710,642 associated with an increase in the number of employees, a focus on operational projects during the year and increased pay-for-performance compensation. Corporate property and liability insurance expense increased $73,647 on higher premiums associated with liability and workers compensation coverage. Professional services increased $217,048 due to increases in external audit fees, completion of an SCC mandated depreciation study on Roanoke Gas Company s assets, consulting services related to Sarbanes-Oxley Section 404 compliance, and consulting services related to the Company s pipeline integrity management program. The Company also incurred a fee of $125,547 for early termination of the $1,700,000 fixed rate note for Highland Propane. However, the Company experienced a reduction in operations bad debt expense of $89,313 related to enhanced collection efforts.

Maintenance expenses increased by $189,046, or 12.2%, as the Company completed a substantial amount of work on sections of the natural gas distribution system that are not buried in the ground, primarily on bridges, consisting of painting and/or wrapping exposed pipe to prevent corrosion. The Company also wrote off certain old and obsolete maintenance materials inventory no longer considered useful and performed additional facility, buildings and ground maintenance.

General taxes increased $127,743, or 9.3%, in fiscal 2004 compared to fiscal 2003 due to higher business and occupation (B&O) taxes, a revenue sensitive tax related to the West Virginia natural gas operations, which accounted for approximately half of the increase in general taxes. The remainder of the increase was associated with higher net payroll tax expense related to greater levels of operations and maintenance labor and increased property taxes associated with greater levels of taxable property.

Depreciation expense increased $125,151, or 3.3%, due to capital expenditures associated with system expansion for adding new natural gas customers, significant pipeline and facility renewal projects, and software and computer hardware upgrades. The level of increase in depreciation expense was smaller than would otherwise be expected due to the implementation of new depreciation rates for Roanoke Gas Company effective January 1, 2004. A depreciation study was completed and the new rates were approved by the SCC. The new depreciation rates would result in approximately $100,000 less depreciation expense on an annual basis, based upon plant account balances on the effective date.

Other expenses, net, decreased $131,116, or 87%, primarily due to investment income earned on the investment of proceeds from the sale of the propane operations. The Company received approximately $28.5 million from the sale of propane assets and invested the proceeds in short-term investments after retiring debt and making income-tax estimates, pending the payment of the $4.50 per share special dividend payable on December 8, 2004.

INTEREST EXPENSE - Total interest expense for fiscal 2004 decreased $81,233, or 4.1%, from fiscal 2003, although total average debt outstanding during the year increased 6.0%.

Debt Summary:

Year Ended September 30,	2004	2003	Increase/ (Decrease)	Percentage
Average Daily Balance:				
Long-term Fixed Rate Debt	**$ 23,688,524**	$ 24,702,191	$ (1,013,667)	-4.1%
Long-term Variable Rate Debt	**2,000,000**		2,000,000	100.0%
Short-term Variable Rate Debt	**9,224,905**	8,248,874	976,031	11.8%
Total Variable Rate Debt	**11,224,905**	8,248,874	2,976,031	36.1%
Total Debt	**34,913,429**	32,951,065	1,962,364	6.0%
Average Interest Rate:				
Long-term Fixed Rate Debt	**6.89%**	7.13%	-0.24%	-3.4%
Variable Rate Debt	**1.92%**	1.99%	-0.07%	-3.5%

The decrease in interest expense resulted from a combination of the new variable-rate $2,000,000 Bluefield Gas note that replaced a 7.28% fixed rate note, the payoff of $1,000,000 installment of Roanoke Gas debt issue with a 9.2% coupon rate and lower average rate on the Company s line of credit balances. The downward trend in short-term interest rates experienced by the Company on its line-of-credit accounts ended in June 2004 when short term interest rates moved upward in response to market pressures and Federal Reserve actions. The above analysis does not include the $4,200,000 in Diversified Energy debt that was retired in July 2004 and the corresponding interest expense included in discontinued operations on the income statement.

INCOME TAXES - Income tax expense from continuing operations increased $54,571, or 4.7%, from last year as both pre-tax earnings and the federal income tax rate increased as a result of the gain realized on the sale of assets. The total effective tax rate for fiscal 2004 was 37.2% compared to 36.9% in fiscal 2003.

NET INCOME AND DIVIDENDS - Income from continuing operations for fiscal 2004 was $2,066,802 as compared to fiscal 2003 income from continuing operations of $1,998,779. The improvement in income from continuing operations derived from the non-gas cost rate increase, which more than offset the impact of a significantly warmer winter and higher operations and maintenance expenses. Basic and diluted earnings per share from continuing operations were $1.02 and $1.01 in fiscal 2004 compared with $1.01 and $1.00 in fiscal 2003, respectively. Dividends per share of common stock, excluding the special $4.50 dividend declared to shareholders related to the gain on sale of assets, were $1.17 in fiscal 2004 and $1.14 in fiscal 2003.

FISCAL YEAR 2003 COMPARED WITH FISCAL YEAR 2002 - REVISED TO EXCLUDE DISCONTINUED OPERATIONS

GROSS REVENUES - Total gross revenue increased $19,522,835, or 28.2%, for the year ended September 30, 2003 (fiscal 2003) compared to the year ended September 30, 2002 (fiscal 2002). The increase in revenues resulted from a combination of higher energy costs and increased sales volume attributable to significantly colder weather. The average per unit cost of natural gas increased by 17 percent for fiscal 2003 over fiscal 2002.

GROSS MARGIN - Total gross margin increased $2,395,981, or 12.3%, for fiscal 2003 compared to fiscal 2002.

Year Ended September 30,	**2003**	**2002**	**Increase/ (Decrease)**	**Percentage**
Gross Margin				
Gas Utilities	$ 21,425,681	$ 19,031,178	$ 2,394,503	12.6%
Energy Marketing	285,042	265,661	19,381	7.3%
Other	207,502	225,405	(17,903)	-7.9%
Total Gross Margin	$ 21,918,225	$ 19,522,244	$ 2,395,981	12.3%

Regulated natural gas margins increased $2,394,503, or 12.6%, primarily due to increased delivered volumes attributable to much colder winter weather and implementation of new billing rates in fiscal 2003. Total delivered natural gas volumes (tariff and transportation) increased 1,477,679 dekatherms (DTH), or 14.0%. Residential and commercial sales accounted for a majority of the increased sales volume due to the weather sensitive nature of those customers. Heating degree days (an industry measure by which the average daily temperature falls below 65 degrees Fahrenheit) increased by 24.2% over fiscal 2002; however, fiscal 2003 heating degree days were only 3% higher than the 30 year normal. Transportation service customers also reflected a net increase as an improving economy led to increased production resulting in higher gas usage for processes.

During fiscal 2003, the Company implemented new rates in accordance with orders from the Virginia SCC and the West Virginia PSC. These new rates affected margins by increasing the customer base charge and changing the rate structure to allow for the direct recovery of the costs associated with financing natural gas inventory and prepaid gas service. The customer base charge, which is a flat monthly fee billed to each natural gas customer, increased by $384,600 for fiscal 2003 associated with the implementation of the increase in December 2002. In April 2003, Roanoke Gas Company implemented new rates that would allow the Company to recover the specific costs associated with financing its investment in gas inventory and prepaid gas service. Prior to April 2003, billing rates included a component to recover the financing costs based upon historical inventory levels and historical interest rates and the allowed rate of return on equity. Therefore, when costs increased, the Company had to absorb the higher financing costs without rate relief. The new rate structure provided for a different recovery mechanism, which also resulted in different timing of revenue recognition. The Company is able to recover higher financing costs related to increased inventory and prepaid gas balances arising from higher gas costs; conversely, the Company will pass along savings to customers if financing costs decrease due to lower inventory and prepaid gas balances resulting from reductions in gas costs. The new rate structure resulted in the recognition of additional revenue related to the recovery of these financing costs during fiscal 2003. Under the new rate structure, the revenue associated with the calculated carrying cost