
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-Q

(Mark one)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2010

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File No. 0-8788

DELTA NATURAL GAS COMPANY, INC.

(Exact Name of Registrant as Specified in its Charter)

Kentucky
(State or other jurisdiction of incorporation or organization)

61-0458329
(I.R.S. Employer Identification No.)

3617 Lexington Road, Winchester, Kentucky
(Address of principal executive offices)

40391
(Zip Code)

859-744-6171

(Registrant's Telephone Number, including area code)

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 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 the definitions of "large accelerated filer" "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of March 31, 2010, Delta Natural Gas Company, Inc. had 3,331,269 shares of Common Stock outstanding.

DELTA NATURAL GAS COMPANY, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**DELTA NATURAL GAS COMPANY, INC.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)**

	Three Months Ended March 31,		Nine Months Ended March 31,		Twelve Months Ended March 31,	
	2010	2009	2010	2009	2010	2009
OPERATING REVENUES	\$ 36,090,839	\$ 43,160,716	\$ 65,336,222	\$ 95,226,774	\$ 75,746,272	\$ 117,785,177
OPERATING EXPENSES						
Purchased gas	\$ 22,984,832	\$ 30,450,810	\$ 38,767,555	\$ 66,855,758	\$ 43,989,428	\$ 82,785,690
Operation and maintenance	3,757,526	3,333,789	10,187,280	11,315,493	13,902,074	15,973,622
Depreciation and amortization	985,130	965,800	2,951,983	2,877,086	3,929,996	3,816,658
Taxes other than income taxes	584,184	490,829	1,523,686	1,375,105	2,029,188	1,813,338
Total operating expenses	\$ 28,311,672	\$ 35,241,228	\$ 53,430,504	\$ 82,423,442	\$ 63,850,686	\$ 104,389,308
OPERATING INCOME	\$ 7,779,167	\$ 7,919,488	\$ 11,905,718	\$ 12,803,332	\$ 11,895,586	\$ 13,395,869
OTHER INCOME AND DEDUCTIONS, NET	38,551	(13,229)	120,040	(100,486)	174,107	(53,327)
INTEREST CHARGES	1,039,901	1,083,260	3,150,923	3,493,437	4,185,142	4,534,483
NET INCOME BEFORE INCOME TAXES	\$ 6,777,817	\$ 6,822,999	\$ 8,874,835	\$ 9,209,409	\$ 7,884,551	\$ 8,808,059
INCOME TAX EXPENSE	2,445,739	2,563,125	3,192,885	3,447,316	2,753,966	3,281,546
NET INCOME	\$ 4,332,078	\$ 4,259,874	\$ 5,681,950	\$ 5,762,093	\$ 5,130,585	\$ 5,526,513
BASIC AND DILUTED EARNINGS PER COMMON SHARE	\$ 1.30	\$ 1.29	\$ 1.71	\$ 1.74	\$ 1.54	\$ 1.67
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING (BASIC AND DILUTED)	3,328,667	3,309,385	3,324,228	3,303,291	3,321,764	3,300,636
DIVIDENDS DECLARED PER COMMON SHARE	\$.325	\$.32	\$.975	\$.96	\$ 1.295	\$ 1.27

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

DELTA NATURAL GAS COMPANY, INC.
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2010	June 30, 2009	March 31, 2009
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	\$ 6,229,319	\$ 122,589	\$ 873,672
Accounts receivable, less accumulated allowances for doubtful accounts of \$593,000, \$819,000 and \$943,000, respectively	12,642,587	4,085,867	15,260,527
Gas in storage, at average cost	1,999,378	9,746,768	6,937,736
Deferred gas costs	1,640,256	2,356,943	2,702,140
Materials and supplies, at average cost	522,531	662,805	607,140
Prepayments	1,092,532	2,415,527	2,093,397
Total current assets	\$ 24,126,603	\$ 19,390,499	\$ 28,474,612
PROPERTY, PLANT AND EQUIPMENT	\$ 202,308,352	\$ 199,254,216	\$ 198,259,043
Less-Accumulated provision for depreciation	(73,082,758)	(70,616,271)	(69,959,549)
Net property, plant and equipment	\$ 129,225,594	\$ 128,637,945	\$ 128,299,494
OTHER ASSETS			
Cash surrender value of life insurance	\$ 446,935	\$ 412,661	\$ 378,047
Prepaid pension cost	-	-	3,525,992
Regulatory assets	11,342,643	11,394,844	7,623,242
Unamortized debt expense and other	2,634,695	2,669,346	2,692,616
Total other assets	\$ 14,424,273	\$ 14,476,851	\$ 14,219,897
Total assets	\$ 167,776,470	\$ 162,505,295	\$ 170,994,003

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

DELTA NATURAL GAS COMPANY, INC.
CONSOLIDATED BALANCE SHEETS (continued)
(UNAUDITED)

	<u>March 31,</u> <u>2010</u>	<u>June 30,</u> <u>2009</u>	<u>March 31,</u> <u>2009</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES			
Accounts payable	\$ 6,479,304	\$ 4,691,152	\$ 4,140,121
Notes payable	—	3,653,103	10,658,133
Current portion of long-term debt	1,200,000	1,200,000	1,200,000
Accrued taxes	1,877,997	983,376	2,645,360
Customers' deposits	656,752	508,209	614,141
Accrued interest on debt	856,239	857,810	855,966
Accrued vacation	693,173	712,216	675,975
Deferred income taxes	172,339	814,549	1,626,836
Other	573,319	487,925	476,480
Total current liabilities	<u>\$ 12,509,123</u>	<u>\$ 13,908,340</u>	<u>\$ 22,893,012</u>
LONG-TERM DEBT	<u>\$ 57,179,000</u>	<u>\$ 57,599,000</u>	<u>\$ 57,709,000</u>
LONG-TERM LIABILITIES			
Deferred income taxes	\$ 31,715,077	\$ 27,537,908	\$ 25,720,038
Investment tax credits	121,550	144,500	152,825
Regulatory liabilities	1,382,676	1,710,099	1,863,913
Accrued pension	710,369	430,095	—
Asset retirement obligations and other	2,389,825	2,176,171	2,155,192
Total long-term liabilities	<u>\$ 36,319,497</u>	<u>\$ 31,998,773</u>	<u>\$ 29,891,968</u>
COMMITMENTS AND CONTINGENCIES (Note 8)			
Total liabilities	<u>\$ 106,007,620</u>	<u>\$ 103,506,113</u>	<u>\$ 110,493,980</u>
SHAREHOLDERS' EQUITY			
Common shares (\$1.00 par value), 20,000,000 shares authorized, 3,331,269, 3,318,046 and 3,313,275 shares outstanding at March 31, 2010, June 30, 2009 and March 31, 2009, respectively	\$ 3,331,269	\$ 3,318,046	\$ 3,313,275
Premium on common shares	44,780,788	44,465,601	44,359,433
Retained earnings	13,656,793	11,215,535	12,827,315
Total shareholders' equity	<u>\$ 61,768,850</u>	<u>\$ 58,999,182</u>	<u>\$ 60,500,023</u>
Total liabilities and shareholders' equity	<u>\$ 167,776,470</u>	<u>\$ 162,505,295</u>	<u>\$ 170,994,003</u>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

DELTA NATURAL GAS COMPANY, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

	Nine Months Ended		Twelve Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
COMMON SHARES				
Balance, beginning of period	\$ 3,318,046	\$ 3,295,759	\$ 3,313,275	\$ 3,291,557
Issuance of common shares	13,223	17,516	17,994	21,718
Balance, end of period	<u>\$ 3,331,269</u>	<u>\$ 3,313,275</u>	<u>\$ 3,331,269</u>	<u>\$ 3,313,275</u>
PREMIUM ON COMMON SHARES				
Balance, beginning of period	\$ 44,465,601	\$ 43,967,481	\$ 44,359,433	\$ 43,855,846
Issuance of common shares	315,187	391,952	421,355	503,587
Balance, end of period	<u>\$ 44,780,788</u>	<u>\$ 44,359,433</u>	<u>\$ 44,780,788</u>	<u>\$ 44,359,433</u>
RETAINED EARNINGS				
Balance, beginning of period	\$ 11,215,535	\$ 10,330,345	\$ 12,827,315	\$ 11,586,428
Adoption of FASB Statement No. 158 (net of \$57,699 of tax)	—	(94,300)	—	(94,300)
Balance, beginning of period, as adjusted	\$ 11,215,535	\$ 10,236,045	\$ 12,827,315	\$ 11,492,128
Net income	5,681,950	5,762,093	5,130,585	5,526,513
Dividends declared on common shares (See Consolidated Statements of Income for rates)	(3,240,692)	(3,170,823)	(4,301,107)	(4,191,326)
Balance, end of period	<u>\$ 13,656,793</u>	<u>\$ 12,827,315</u>	<u>\$ 13,656,793</u>	<u>\$ 12,827,315</u>
SHAREHOLDERS' EQUITY				
Balance, beginning of period	\$ 58,999,182	\$ 57,593,585	\$ 60,500,023	\$ 58,733,831
Adoption of FASB Statement No. 158 (net of \$57,699 of tax)	—	(94,300)	—	(94,300)
Balance, beginning of period, as adjusted	\$ 58,999,182	\$ 57,499,285	\$ 60,500,023	\$ 58,639,531
Net income	5,681,950	5,762,093	5,130,585	5,526,513
Issuance of common shares	328,410	409,468	439,349	525,305
Dividends on common shares	(3,240,692)	(3,170,823)	(4,301,107)	(4,191,326)
Balance, end of period	<u>\$ 61,768,850</u>	<u>\$ 60,500,023</u>	<u>\$ 61,768,850</u>	<u>\$ 60,500,023</u>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

DELTA NATURAL GAS COMPANY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended		Twelve Months Ended	
	March 31		March 31	
	2010	2009	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	\$ 5,681,950	\$ 5,762,093	\$ 5,130,585	\$ 5,526,513
Adjustments to reconcile net income to net cash flows from operating activities				
Depreciation and amortization	3,332,341	3,257,442	4,437,137	4,323,432
Provision for inventory adjustment	—	1,350,300	—	1,350,300
Deferred income taxes and investment tax credits	3,419,631	1,214,049	4,340,929	2,435,202
Gain on sale of property, plant and equipment	—	(156,023)	—	(172,978)
Other, net	(290,443)	(327,139)	(386,974)	(393,126)
Change in cash surrender value of life insurance	(34,274)	66,265	(68,888)	47,562
Decrease (increase) in assets	1,092,241	2,357,243	12,992,784	(4,226,307)
Increase (decrease) in liabilities	3,483,561	(6,857,006)	(1,165,585)	(4,808,487)
Net cash provided by operating activities	<u>\$ 16,685,007</u>	<u>\$ 6,667,224</u>	<u>\$ 25,279,988</u>	<u>\$ 4,082,111</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Capital expenditures	\$ (3,671,123)	\$ (6,959,987)	\$ (5,021,857)	\$ (8,661,715)
Proceeds from sale of property, plant and equipment	138,231	457,589	207,407	497,087
Other	(60,000)	—	(60,000)	—
Net cash used in investing activities	<u>\$ (3,592,892)</u>	<u>\$ (6,502,398)</u>	<u>\$ (4,874,450)</u>	<u>\$ (8,164,628)</u>
CASH FLOWS FROM FINANCING ACTIVITIES				
Dividends on common shares	\$ (3,240,692)	\$ (3,170,823)	\$ (4,301,107)	\$ (4,191,326)
Issuance of common shares	328,410	409,468	439,349	525,305
Repayment of long-term debt	(420,000)	(609,000)	(530,000)	(693,000)
Borrowings on bank line of credit	25,205,557	66,476,908	32,835,706	74,074,605
Repayment of bank line of credit	(28,858,660)	(62,647,566)	(43,493,839)	(66,703,654)
Net cash provided by (used in) financing activities	<u>\$ (6,985,385)</u>	<u>\$ 458,987</u>	<u>\$ (15,049,891)</u>	<u>\$ 3,011,930</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	\$ 6,106,730	\$ 623,813	\$ 5,355,647	\$ (1,070,587)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>122,589</u>	<u>249,859</u>	<u>873,672</u>	<u>1,944,259</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 6,229,319</u>	<u>\$ 873,672</u>	<u>\$ 6,229,319</u>	<u>\$ 873,672</u>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

DELTA NATURAL GAS COMPANY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(1) Nature of Operations

Delta Natural Gas Company, Inc. (“Delta” or “the Company”) distributes or transports natural gas to approximately 37,000 customers. Our distribution and transmission systems are located in central and southeastern Kentucky and we own and operate an underground storage field in southeastern Kentucky. We transport natural gas to our industrial customers who purchase their gas in the open market. We also transport natural gas on behalf of local producers and customers not on our distribution system. We have three wholly-owned subsidiaries. Delta Resources, Inc. buys gas and resells it to industrial or other large use customers on Delta’s system. Delgasco, Inc. buys gas and resells it to Delta Resources, Inc. and to customers not on Delta’s system. Enpro, Inc. owns and operates production properties and undeveloped acreage.

(2) Basis of Presentation

All subsidiaries of Delta are included in the consolidated financial statements. Intercompany balances and transactions have been eliminated. All adjustments necessary for a fair presentation of the unaudited results of operations for the three, nine and twelve months ended March 31, 2010 and 2009 are included. All such adjustments are accruals of a normal and recurring nature other than the inventory adjustment discussed in Note 11 to adjust our gas in storage during the nine and twelve months ended March 31, 2009.

The results of operations for the periods ended March 31, 2010 are not necessarily indicative of the results of operations to be expected for the full fiscal year. Because of the seasonal nature of our sales, we generate the smallest proportion of cash from operations during the warmer months, when sales volumes decrease considerably. Most construction activity and gas storage injections take place during these warmer months. Twelve month ended financial information is provided for additional information only.

The accompanying consolidated financial statements are unaudited and should be read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended June 30, 2009.

Recently Adopted Accounting Standards

In June 2009, the Financial Accounting Standards Board issued Statement No. 168, entitled The FASB Accounting Standards Codification (“Codification”) and the Hierarchy of Generally Accepted Accounting Principles (“GAAP”), which establishes the Codification as the single source of authoritative GAAP recognized by the Financial Accounting Standards Board. Securities and Exchange Commission (“SEC”) rules and interpretive releases are also sources of authoritative generally accepted accounting principles for SEC registrants. Statement No. 168 was effective for periods ending after September 15, 2009. Statement No. 168 did not change or alter existing GAAP, therefore it did not impact our results of operations, cash flows or financial position. We have adjusted historical GAAP references in our SEC filings to reflect accounting guidance references included in the Codification.

Effective July 1, 2009, we adopted Codification Topic 820, entitled Fair Value Measurement and Disclosures, as it relates to nonfinancial assets and nonfinancial liabilities that are measured at fair value on a nonrecurring basis. Our nonfinancial assets and liabilities measured at fair value on a nonrecurring basis consist of our asset retirement obligations, which are measured at fair value only upon initial recognition. The adoption did not have a material impact on our results of operations or financial position.

In August 2009, the Financial Accounting Standards Board issued Accounting Standards Update No. 2009-05, entitled Fair Value Measurements and Disclosures (Topic 820) – Measuring Liabilities at Fair Value. Update No. 2009-05 provides additional guidance in measuring the fair value of liabilities when a lack of observable market information exists to value the liability from an exit price perspective. We

adopted the provisions of Update No. 2009-05 effective for our quarter ended September 30, 2009 and the adoption did not impact our results of operations or financial position.

In January, 2010, the Financial Accounting Standards Board issued Accounting Standards Update No. 2010-06, entitled Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures about Fair Value Measurements. Update No. 2010-06 requires entities with fair value measurements to disaggregate major categories of assets and liabilities within the disclosures, disclose transfers between levels within the fair value hierarchy and disclose inputs and valuation techniques for Level 2 and Level 3 fair value measurements. We adopted the provisions of Update No. 2010-06 for our quarter ended March 31, 2010 and the adoption did not impact our results of operations or financial position.

Recently Issued Accounting Standards

In December, 2008, the Financial Accounting Standards Board issued Financial Accounting Standards Board Staff Position No. FAS 132(R)-1, entitled Employer's Disclosures about Postretirement Benefit Plan Assets. Upon issuance of the Accounting Standards Codification, the provisions of Staff Position No. FAS 132(R)-1 were superseded and added as pending content to Codification Topic 715-20, entitled Defined Benefit Plans – General. The pending content provides for additional disclosure to increase transparency surrounding the types of assets and risks associated with a defined benefit pension or other postretirement plan. Codification Topic 715-20, as amended, will require employers to provide additional disclosure surrounding investment strategies, major categories of plan assets, and valuation techniques used to measure the fair value of plan assets. The pending content, which shall be effective for our fiscal year ending June 30, 2010, will not impact our results of operations or financial position.

(3) Fair Value Measurements

Pursuant to Codification Topic 820, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition focuses on an exit price, which is the price that would be received by us to sell an asset or paid to transfer a liability versus an entry price, which would be the price paid to acquire an asset or received to assume a liability. Although additional fair value measurements are not required, the guidance in Codification Topic 820 applies to other accounting pronouncements that require or permit fair value measurements.

We determine the fair value of financial assets and liabilities based on the following fair value hierarchy, as prescribed by Codification Topic 820, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

- Level 1 – Observable inputs such as quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3 – Unobservable inputs which require the reporting entity to develop its own assumptions.

Our financial assets and liabilities measured at fair value on a recurring basis consist of the assets of our supplemental retirement benefit trust, which are included in unamortized debt expense and other on the Consolidated Balance Sheets. The offsetting liability is included in asset retirement obligations and other on the Consolidated Balance Sheets. Contributions to the trust are presented in other investing activities on the Consolidated Statement of Cash Flows. The liability is not considered a financial liability within the scope of Codification Topic 820. The assets of the trust are recorded at fair value and consist of exchange traded mutual funds. The mutual funds are recorded at fair value using observable market prices from active markets, which are categorized as Level 1 in the fair value hierarchy. The fair value of the trust assets are as follows:

(\$000)	<u>March 31, 2010</u>	<u>June 30, 2009</u>	<u>March 31, 2009</u>
Trust assets	394	281	255

The carrying amounts of our other financial instruments including cash equivalents, accounts receivable, notes receivable and accounts payable approximate their fair value.

Our Debentures and Insured Quarterly Notes, presented as current portion of long-term debt and long-term debt on the Consolidated Balance Sheets, are stated at historical cost. Fair value of our long-term debt is based on the expected future cash flows of the debt discounted using a credit adjusted risk-free rate. The Insured Quarterly Notes contain insurance that provides for the continuing payment of principal and interest to the holders in the event we default on the Insured Quarterly Notes. Upon default, the insurer would pay interest and principal to the holders through the maturity of the Insured Quarterly Notes and our obligation transfers to the insurer. Therefore, the insurance is not considered in the determination of the fair value of the Insured Quarterly Notes.

(\$000)	<u>March 31, 2010</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>
7% Debentures	19,470	19,272
5.75% Insured Quarterly Notes	38,909	34,647

Our nonfinancial assets and nonfinancial liabilities that are measured at fair value on a nonrecurring basis consist of our asset retirement obligations. Our asset retirement obligations are measured at fair value upon initial recognition based on the expected future cash flows of the obligation and are considered to be Level 3 fair value measurements. During the quarter ended March 31, 2010, we recognized asset retirement obligations for natural gas liquids storage tanks placed into service in the amount of \$2,000. The expected future cash flows of the obligation are based on cost estimates to have a third party retire the underlying asset discounted using a credit adjusted risk-free rate. The credit adjusted risk-free rate is determined based on the daily treasury yield curve adjusted for credit risk based on recent trades of our Debentures. Additionally, certain future events may require us to evaluate long-lived assets for impairment to determine if their carrying value exceeds their fair value.

Entities are permitted to electively measure many financial instruments and certain other items at fair value. We do not currently have any financial assets or financial liabilities for which the fair value option has been elected. However, in the future, we may elect to measure certain financial instruments at fair value in accordance with Codification Topic 820.

(4) Risk Management and Derivative Instruments

To varying degrees, our regulated and non-regulated segments are exposed to commodity price risk. We purchase our gas supply through a combination of spot market gas purchases and forward gas purchases. We mitigate price risk by efforts to balance supply and demand. None of our gas contracts are accounted for using the fair value method of accounting. While some of our gas purchase contracts and gas sales contracts meet the definition of a derivative, we have designated these contracts as “normal purchases” and “normal sales” under Codification Topic 815, entitled Derivatives and Hedging.

(5) Unbilled Revenue

We bill our customers on a monthly meter reading cycle. At the end of each month, gas service which has been rendered from the date the customer's meter was last read to the month-end is unbilled.

Unbilled revenues and gas costs include the following:

(000)	<u>March 31, 2010</u>	<u>June 30, 2009</u>	<u>March 31, 2009</u>
Unbilled revenues (\$)	4,527	1,386	6,022
Unbilled gas costs (\$)	2,274	519	3,660
Unbilled volumes (Mcf)	377	55	311

Unbilled revenues are included in accounts receivable and unbilled gas costs are included in deferred gas costs on the accompanying Consolidated Balance Sheets.

(6) Defined Benefit Retirement Plan

Net periodic benefit cost for our trustee, noncontributory defined benefit pension plan for the periods ended March 31 include the following:

(\$000)	<u>Three Months Ended March 31,</u>		<u>Nine Months Ended March 31,</u>		<u>Twelve Months Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Service cost	182	169	546	508	715	695
Interest cost	214	203	641	608	843	794
Expected return on plan assets	(238)	(253)	(715)	(758)	(967)	(1,005)
Amortization of unrecognized net loss	124	55	373	163	427	225
Amortization of prior service cost	(22)	(22)	(65)	(65)	(86)	(86)
Net periodic benefit cost	<u>260</u>	<u>152</u>	<u>780</u>	<u>456</u>	<u>932</u>	<u>623</u>

(7) Notes Payable

The current bank line of credit with Branch Banking and Trust Company is \$40,000,000, all of which was available at March 31, 2010. As of June 30, 2009 and March 31, 2009, \$3,653,000 and \$10,658,000, respectively, were borrowed having a weighted average interest rate of 1.8% and 1.3%, respectively. Our bank line of credit extends through June 30, 2011. The interest rate on the used bank line of credit is the London Interbank Offered Rate plus 1.5%, and the annual cost of the unused bank line of credit is .125%.

Our bank line of credit agreement and the Indentures relating to all of our publicly held Debentures and Insured Quarterly Notes contain defined “events of default” which, among other things, can make the obligations immediately due and payable. Of these, we consider the following covenants to be most restrictive:

- Dividend payments cannot be made unless consolidated shareholders’ equity of the Company exceeds \$25,800,000 (thus no retained earnings were restricted); and
- we may not assume any additional mortgage indebtedness in excess of \$5,000,000 without effectively securing all Debentures and Insured Quarterly Notes equally to such additional indebtedness.

Furthermore, a default on the performance on any single obligation incurred in connection with our borrowings simultaneously creates an event of default with the bank line of credit and all of the Debentures and Insured Quarterly Notes. We were not in default on any of our bank line of credit, Debentures or Insured Quarterly Notes during any period presented.

(8) Commitments and Contingencies

We have entered into individual employment agreements with our four officers. The agreements expire or may be terminated at various times. The agreements provide for continuing monthly payments or lump sum payments and the continuation of specified benefits over varying periods in certain cases following defined changes in ownership of the Company. In the event all of these agreements were exercised in the form of lump sum payments, approximately \$3.0 million would be paid in addition to continuation of specified benefits for up to five years.

The Kentucky Department of Revenue has assessed Delta Resources \$824,000, which includes \$406,000 in taxes, \$285,000 in penalties and \$133,000 in interest for failure to collect and remit a 3% Utility Gross Receipts License tax for the period July through December, 2005. The tax is a 3% license tax levied on the gross billing by a utility and is passed through to its customers. Case law in the state of Kentucky and opinions issued by the State Attorney General support that the Utility Gross Receipts License Tax is applicable only to regulated utilities. Since Delta Resources is a natural gas marketer and not a utility regulated by the Kentucky Public Service Commission, we believe Delta Resources is exempt from the tax. We have protested the assessment, but cannot currently predict the outcome of the protest. As of March 31, 2010, we have not accrued any amounts related to the contingency.

In the event we are unsuccessful in defending the position, Delta Resources would have the right to seek reimbursement from its customers for amounts paid to the Department of Revenue relating to this assessment, leaving Delta Resources potentially liable for the interest component of the assessment and any uncollectible amounts. However, we would not be liable for penalties as Kentucky law provides a waiver of penalties when, as we have done, the tax position taken is done so in good faith upon the analysis and recommendation of legal counsel.

Although the Kentucky Department of Revenue has not asserted a claim for the tax periods after December, 2005, we have calculated that potential future unasserted liabilities could approximate \$4.3 million, which includes estimated taxes, penalties and interest.

We are not a party to any material pending legal proceedings.

We have entered into forward purchase agreements beginning in July, 2009 and expiring at various dates through October, 2010. These agreements require us to purchase minimum amounts of natural gas throughout the term of the agreements. These agreements are established in the normal course of business to ensure adequate gas supply to meet our customers' gas requirements. The remaining aggregate minimum purchase obligations for these agreements are \$110,000 and \$143,000 for our fiscal years ended June 30, 2010 and 2011, respectively.

(9) Regulatory Matters

The Kentucky Public Service Commission exercises regulatory authority over our retail natural gas distribution and transportation services. The Kentucky Public Service Commission's regulation of our business includes setting the rates we are permitted to charge our regulated customers. The rates we currently charge our regulated customers were implemented in October, 2007. We monitor our need to file requests with the Kentucky Public Service Commission for a general rate increase for our natural gas and transportation services.

On April 23, 2010, we filed a request for increased rates with the Kentucky Public Service Commission. This general rate case, Case No. 2010-00116, requests an annual revenue increase of approximately \$5,315,000, an increase of 11.5%. The rate case utilizes a test year of the twelve months ended December 31, 2009 and requests a return on common equity of 12.0%. The request allocates a majority of the requested increase to the fixed monthly customer charge as opposed to the volumetric rate, and therefore the increase in revenue would be less dependent on customer usage and should occur more evenly throughout the year.

In addition to the request for increased rates, we proposed a pipe replacement program that would allow us to adjust rates annually to earn a return on capital expenditures incurred subsequent to the test year which are associated with the replacement of pipe and related facilities. The pipe replacement program is designed to additionally recover the costs associated with the mandatory relocation of facilities. We also proposed a change to our gas cost recovery clause to include the uncollectible gas cost portion of bad debt expense as a component of the gas cost recovery rate.

The filing requested the increased rates to be effective May 23, 2010; however, as a matter of general practice, the Kentucky Public Service Commission normally suspends the implementation of proposed rates for a period of five months from the effective date, during which time the filing is reviewed.

Although management is of the opinion that its request is reasonable, we are unable to predict the outcome of the proceeding.

On March 23, 2010, we filed our quarterly application for a change in the gas cost recovery rate we charge our distribution customers. The proposed rate of \$6.2362 per Mcf was to be effective April 26, 2010; however, on April 7, 2010, we received an order from the Kentucky Public Service Commission suspending the proposed gas cost recovery rate until September 25, 2010 pending further proceedings to determine the reasonableness of the proposed rates. The order included a data request to which we provided responses on April 19, 2010. We cannot predict the outcome of this proceeding. As a result of the suspension, our current gas cost recovery rate of \$6.0358 per Mcf approved by the Kentucky Public Service Commission on January 15, 2010 remains in effect.

(10) Operating Segments

Our Company has two segments: (i) a regulated natural gas distribution, transmission and storage segment and (ii) a non-regulated segment that participates in related ventures, consisting of natural gas marketing and production. The regulated segment serves residential, commercial and industrial customers in the single geographic area of central and southeastern Kentucky. Virtually all of the revenue recorded under both segments comes from the distribution or transportation of natural gas. Price risk for the regulated segment is mitigated through our gas cost recovery clause, approved quarterly by the Kentucky Public Service Commission. Price risk for the non-regulated segment is mitigated by efforts to balance supply and demand. However, there are greater risks in the non-regulated segment because of the practical limitations on the ability to perfectly predict our demand. In addition, we are exposed to price risk resulting from changes in the market price of gas and uncommitted gas volumes of our non-regulated companies.

The segments follow the same accounting policies as described in the Summary of Significant Accounting Policies in Note 1 of the Notes to Consolidated Financial Statements which are included in our Annual Report on Form 10-K for the year ended June 30, 2009. Intersegment revenues and expenses consist of intercompany revenues and expenses from intercompany gas transportation services. Intersegment transportation revenues and expenses are recorded at our tariff rates. Appropriate related operating expenses, taxes and interest are allocated to the non-regulated segment.

Segment information is shown below for the periods:

(\$000)	Three Months Ended March 31,		Nine Months Ended March 31,		Twelve Months Ended March 31,	
	2010	2009	2010	2009	2010	2009
Operating Revenues						
Regulated						
External customers	20,766	28,202	39,838	57,028	47,288	66,434
Intersegment	1,338	1,125	2,757	2,858	3,326	3,709
Total regulated	22,104	29,327	42,595	59,886	50,614	70,143
Non-regulated						
External customers	15,325	14,959	25,498	38,199	28,458	51,351
Eliminations for intersegment	(1,338)	(1,125)	(2,757)	(2,858)	(3,326)	(3,709)
Total operating revenues	<u>36,091</u>	<u>43,161</u>	<u>65,336</u>	<u>95,227</u>	<u>75,746</u>	<u>117,785</u>
Net Income						
Regulated	3,309	3,215	4,038	3,625	3,892	3,093
Non-regulated	1,023	1,045	1,644	2,137	1,239	2,434
Total net income	<u>4,332</u>	<u>4,260</u>	<u>5,682</u>	<u>5,762</u>	<u>5,131</u>	<u>5,527</u>

(11) Gas In Storage Inventory Adjustment

We operate a natural gas underground storage field that we utilize to inject and store natural gas during the non-heating season, and we then withdraw natural gas during the heating season to meet our customers' needs. We periodically analyze the volumes, pressure and other data relating to the storage field in order to substantiate the gas inventory carried in our perpetual inventory records.

Fiscal 2009 storage field data suggested that an inventory adjustment was required related to a storage well that allowed natural gas to escape. After analyzing the data, we estimated that the adjustment amount would be in the range of \$1,350,000 to \$1,750,000. Based on the storage field data available at the time, we could not determine if any amount within the range was more likely than any other; therefore, we recorded a gas in storage inventory adjustment in the amount of \$1,350,000. The adjustment was included in operation and maintenance expense in the Consolidated Statements of Income for the nine and twelve months ended March 31, 2009.

Fiscal 2010 storage field data has been inconclusive as to whether any additional inventory adjustment is required. We will continue to evaluate storage field data and record inventory adjustments as required. Potential future adjustments may be in amounts within or exceeding the range determined in 2009.

On March 23, 2009, we filed an insurance claim for \$1,350,000 relating to the escaped gas. On October 22, 2009, we received the preliminary findings from the external consultant engaged by the insurance company to review our claim. The preliminary findings challenge our right to recover the full amount of the claim. We disagree with the consultant's preliminary findings and have filed a rebuttal with the insurance company. We cannot predict the amount of any insurance proceeds.

Our current rate case includes as a regulatory expense unreimbursed gas losses related to this adjustment of \$868,000. We have not recorded any insurance recovery asset or regulatory asset in the accompanying consolidated financial statements; however, to the extent recovery becomes probable, we will evaluate recognition of an appropriate asset at that time.

(12) **Share-Based Compensation**

In November, 2009, at the Annual Meeting of Shareholders of Delta Natural Gas Company, Inc., our shareholders adopted and approved the Delta Natural Gas Company, Inc. Incentive Compensation Plan (the "Plan"), which was previously approved by our Board of Directors in August, 2009, subject to shareholder approval. The Plan provides for incentive compensation payable in stock, restricted stock and stock bonus awards. The Plan, which became effective on January 1, 2010, is administered by our Corporate Governance and Compensation Committee of our Board of Directors, which has complete discretion in determining our employees, officers and outside directors who shall be eligible to participate in the Plan, as well as the type, amount, terms and conditions of each award, subject to the limitations of the Plan.

The number of shares of our common stock which may be issued pursuant to the Plan may not exceed in the aggregate 500,000 shares. Shares of common stock may be available from authorized but unissued shares, shares reacquired by us or shares that we purchase in the open market. In February, 2010, we received authorization from the Kentucky Public Service Commission to issue shares pursuant to the Plan and in March, 2010, we registered the shares with the Securities and Exchange Commission. As of March 31, 2010, no awards had been granted and no shares had been issued from the Plan.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

YEAR TO DATE MARCH 31, 2010 OVERVIEW AND FUTURE OUTLOOK

For the nine months ended March 31, 2010, consolidated net income per share of \$1.71 decreased \$.03 per share as compared to the \$1.74 net income per share for the nine months ended March 31, 2009. The decrease is primarily attributable to a 22% decline in our non-regulated segment's gross margins. However, the decline is partially offset by an inventory adjustment we recorded for our gas in storage during the nine months ended March 31, 2009, which is further discussed in Note 11 of the Notes to Consolidated Financial Statements.

Our regulated segment's contribution to consolidated net income for the remainder of 2010 will be dependent upon the continuing impact the weakened economic environment has on our customers. Our customers may choose to discontinue their natural gas service, be unable to pay for their natural gas service or decrease the volumes purchased from or transported by us on behalf of them. Beyond 2010, our success will depend, in part, on our ability to maintain a reasonable rate of return in our regulated segment in light of the weakened economic environment. We filed for a general rate increase with the Kentucky Public Service Commission on April 23, 2010 to recover in our rates increased operating costs and a reasonable return on invested capital. This filing includes the current usage patterns of our customers, and thus addresses the impacts of margin reductions due to customer conservation and customer loss.

Future profitability of the non-regulated segment is dependent on the business plans of some of our industrial and other large use customers and the market prices of natural gas, all of which are out of our control. For the nine months ended March 31, 2010, we experienced a decline in our non-regulated segment's gross margins due to decreased sales prices. We anticipate our non-regulated segment to continue to contribute to our consolidated net income for the remainder of fiscal 2010, based on the contracts currently in place. Additionally, if natural gas prices increase, we would expect to experience a corresponding increase in our non-regulated segment margins related to our natural gas production activities. However, if natural gas prices decrease, we would expect a decrease in our non-regulated margins related to our natural gas production and marketing activities.

LIQUIDITY AND CAPITAL RESOURCES

Operating activities provide our primary source of cash. Cash provided by operating activities consists of net income adjusted for non-cash items, including depreciation, amortization, deferred income taxes, gains on the sale of assets and changes in working capital.

Our ability to maintain liquidity depends on our bank line of credit, shown as notes payable on the accompanying Consolidated Balance Sheets. Notes payable decreased to \$0 at March 31, 2010, compared to

\$3,653,000 at June 30, 2009 and \$10,658,000 at March 31, 2009, due to a decrease in the cost of gas purchased and decreased capital expenditures. Our liquidity is also impacted by the fact we sometimes generate internally only a portion of the cash necessary for our capital expenditure requirements. We made capital expenditures of \$3,671,000 and \$5,022,000 during the nine and twelve months ended March 31, 2010, respectively. In periods when cash provided by operating activities is not sufficient to meet our capital requirements, we finance the balance of our capital expenditures on an interim basis through our bank line of credit.

Long-term debt decreased to \$57,179,000 at March 31, 2010, compared with \$57,599,000 at June 30, 2009 and \$57,709,000 at March 31, 2009. These decreases resulted from the limited redemptions made by certain holders or their beneficiaries as allowed by the Debentures and Insured Quarterly Notes.

Cash and cash equivalents were \$6,229,000 at March 31, 2010, as compared with \$123,000 at June 30, 2009 and \$874,000 at March 31, 2009. These changes in cash and cash equivalents are summarized in the following table:

(\$000)	Nine Months Ended		Twelve Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Provided by operating activities	16,685	6,667	25,280	4,082
Used in investing activities	(3,593)	(6,502)	(4,874)	(8,165)
Provided by (used in) financing activities	(6,985)	459	(15,050)	3,012
Increase (decrease) in cash and cash equivalents	<u>6,107</u>	<u>624</u>	<u>5,356</u>	<u>(1,071)</u>

For the nine months ended March 31, 2010, cash provided by operating activities increased \$10,018,000 (150%). Cash paid for natural gas decreased \$37,735,000 partially offset by a \$34,266,000 decrease in cash received from customers, both of which are attributable to decreases in the cost of gas purchased. Cash paid for taxes decreased \$2,844,000 due to a method change that reduced our capitalization of expenses for income tax purposes. Cash contributed to our defined benefit pension plan decreased \$2,177,000 as we made an elective contribution in the prior year to maintain the funded status of the plan.

For the twelve months ended March 31, 2010, cash provided by operating activities increased \$21,198,000 (519%). Cash paid for natural gas decreased \$57,396,000 partially offset by a \$43,659,000 decrease in cash received from customers, both of which are attributable to decreases in the cost of gas purchased. Cash paid for taxes decreased \$3,261,000 due to a method change that reduced our capitalization of expenses for income tax purposes. Cash contributed to our defined benefit pension plan decreased \$2,488,000 as we made an elective contribution in the prior year to maintain the funded status of the plan.

Changes in cash used in investing activities result primarily from the changes in the level of capital expenditures between years.

For the nine and twelve months ended March 31, 2010, cash used in financing activities increased \$7,444,000 and \$18,062,000, respectively, due to increased net repayments on our bank line of credit.

Cash Requirements

Our capital expenditures result in a continued need for capital. These capital expenditures are being made for system extensions and for the replacement and improvement of existing transmission, distribution, gathering, storage and general facilities. We expect our capital expenditures for fiscal 2010 to be approximately \$6.2 million.

Sufficiency of Future Cash Flows

We expect that cash provided by operations, coupled with short and long-term borrowings, will be sufficient to satisfy our operating and normal capital expenditure requirements and to pay dividends for the next twelve months and the foreseeable future.

To the extent that internally generated cash is not sufficient to satisfy seasonal operating and capital expenditure requirements and to pay dividends, we will rely on our bank line of credit. Our current available bank

line of credit with Branch Banking and Trust Company, shown as notes payable on the accompanying Consolidated Balance Sheets is \$40,000,000, of which \$0 was borrowed at March 31, 2010. The current bank line of credit extends through June 30, 2011.

Our ability to borrow on our bank line of credit is dependent on our compliance with covenants. Our bank line of credit agreement and the Indentures relating to all of our publicly held Debentures and Insured Quarterly Notes contain defined "events of default" which, among other things, can make the obligations immediately due and payable. Of these, we consider the following covenants to be most restrictive:

- Dividend payments cannot be made unless consolidated shareholders' equity of the Company exceeds \$25,800,000 (thus no retained earnings were restricted); and
- we may not assume any additional mortgage indebtedness in excess of \$5,000,000 without effectively securing all Debentures and Insured Quarterly Notes equally to such additional indebtedness.

Furthermore, a default on the performance on any single obligation incurred in connection with our borrowings simultaneously creates an event of default with the bank line of credit and all of the Debentures and Insured Quarterly Notes. We were not in default on any of our bank line of credit, Debentures or Insured Quarterly Notes during any period presented. We are not aware of any events that would cause us to be in default in fiscal 2010.

Our ability to sustain acceptable earnings levels, finance capital expenditures and pay dividends is contingent on the adequate and timely adjustment of the regulated sales and transportation prices we charge our customers. The Kentucky Public Service Commission sets these prices and we monitor our need to file rate requests with the Kentucky Public Service Commission for general rate increases for our regulated services. The rates we currently charge our regulated customers were implemented in October, 2007.

On April 23, 2010, we filed a request for increased rates with the Kentucky Public Service Commission. This general rate case, Case No. 2010-00116, requests an annual revenue increase of approximately \$5,315,000, an increase of 11.5%. The rate case utilizes a test year of the twelve months ended December 31, 2009 and requests a return on common equity of 12.0%. The request allocates a majority of the requested increase to the fixed monthly customer charge as opposed to the volumetric rate, and therefore the increase in revenue would be less dependent on customer usage and should occur more evenly throughout the year.

In addition to the request for increased rates, we proposed a pipe replacement program that would allow us to adjust rates annually to earn a return on capital expenditures incurred subsequent to the test year which are associated with the replacement of pipe and related facilities. The pipe replacement program is designed to additionally recover the costs associated with the mandatory relocation of facilities. We also proposed a change to our gas cost recovery clause to make the uncollectible gas cost portion of bad debt expense a component of the gas cost recovery rate.

The filing requested the increased rates to be effective May 23, 2010; however, as a manner of general practice, the Kentucky Public Service Commission normally suspends the implementation of proposed rates for a period of five months from the effective date, during which time the filing is reviewed.

Although management is of the opinion that its request is reasonable, we are unable to predict the outcome of the proceeding.

On March 23, 2010, we filed our quarterly application for a change in the gas cost recovery rate we charge our distribution customers. The proposed rate of \$6.2362 per Mcf was to be effective April 26, 2010; however, on April 7, 2010, we received an order from the Kentucky Public Service Commission suspending the proposed gas cost recovery rate until September 25, 2010 pending further proceedings to determine the reasonableness of the proposed rates. The order included a data request to which we provided responses on April 19, 2010. We cannot predict the outcome of this proceeding. As a result of the suspension, our current gas cost recovery rate of \$6.0358 per Mcf approved by the Kentucky Public Service Commission on January 15, 2010 remains in effect.

RESULTS OF OPERATIONS

Gross Margins

Our regulated and non-regulated revenues, other than transportation, have offsetting gas expenses. Therefore, throughout the following Results of Operations, we refer to “gross margin”. With respect to our regulated and non-regulated segments, gross margin refers to operating revenues less purchased gas expense, which can be derived directly from our Consolidated Statements of Income. Operating Income as presented on the Consolidated Statements of Income is the most directly comparable financial measure calculated and presented in accordance with accounting principles generally accepted in the United States. “Gross margin” is a “non-GAAP financial measure”, as defined in accordance with SEC rules. We view gross margin as an important performance measure of the core profitability of our operations. The measure is a key component of our internal financial reporting and is used by our management in analyzing our business segments. We believe that investors benefit from having access to the same financial measures that our management uses.

Natural gas prices are determined by an unregulated national market. Therefore, the price that we pay for natural gas fluctuates with national supply and demand. See Item 3 for the impact of forward contracts.

In the following table we set forth variations in our gross margins for the three, nine and twelve months ended March 31, 2010 compared with the same periods in the preceding year. The variation amounts and percentages presented in the following tables for regulated and non-regulated gross margins include intersegment transactions. These intersegment revenues and expenses are eliminated in the Consolidated Statements of Income.

(\$000)	2010 compared to 2009		
	Three Months	Nine Months	Twelve Months
	Ended March 31,	Ended March 31,	Ended March 31,
Increase (decrease) in gross margins:			
Regulated segment			
Gas sales	138	(236)	(389)
On-system transportation	186	203	21
Off-system transportation	112	(258)	(379)
Other	(3)	(33)	(42)
Intersegment elimination (a)	(213)	101	383
Total	220	(223)	(406)
Non-regulated segment			
Gas sales	(72)	(1,467)	(2,388)
Other	35	(12)	(65)
Intersegment elimination (a)	213	(101)	(383)
Total	176	(1,580)	(2,836)
Increase (decrease) in consolidated gross margins	396	(1,803)	(3,242)
Percentage increase (decrease) in volumes			
Regulated segment			
Gas sales	14	4	3
On-system transportation	15	2	(6)
Off-system transportation	8	(11)	(14)
Non-regulated segment			
Gas sales	38	3	(9)

(a) Intersegment eliminations represent the transportation fee charged by the regulated segment to the non-regulated segment.

Heating degree days were 112%, 109% and 107% of normal thirty year average temperatures for the three, nine and twelve months ended March 31, 2010, respectively, as compared with 99%, 101% and 101% of normal temperatures in the 2009 periods. A “heating degree day” results from a day during which the average of the high and low temperature is at least one degree less than 65 degrees Fahrenheit.

For the three months ended March 31, 2010, consolidated gross margins increased \$396,000 (3%) due to increased regulated and non-regulated gross margins of \$220,000 (2%) and \$176,000 (6%), respectively. Our regulated gross margins increased due to an increase in volumes transported for both on-system transportation (15%) and off-system transportation (8%) customers due to an increase our transportation customers’ gas requirements. Additionally, we experienced an increase in regulated volumes sold due to colder than normal weather; however, this increase was partially offset by a reduction in our billing rates attributable to our weather normalization tariff. Our non-regulated gross margins increased due to a 38% increase in volumes sold, partially offset by a 23% decline in sales prices.

For the nine months ended March 31, 2010, consolidated gross margins decreased \$1,803,000 (6%) due to decreases in our non-regulated and regulated gross margins of \$1,580,000 (22%) and \$223,000 (1%), respectively. Our non-regulated gross margins decreased due to a 24% decline in sales prices, partially offset by a 3% increase in volumes sold.

For the twelve months ended March 31, 2010, consolidated gross margins decreased \$3,242,000 (9%) due to decreases in our non-regulated and regulated gross margins of \$2,836,000 (30%) and \$406,000 (2%), respectively. Our non-regulated gross margins decreased due to a 23% decline in sales prices and a 9% decrease in volumes sold. The non-regulated volumes sold decreased due to a decrease in our non-regulated customers’ gas requirements, which we attribute to economic conditions.

Operation and Maintenance

For the three months ended March 31, 2010, operation and maintenance expense increased \$424,000 (13%). The increase was primarily due to increased employee benefit expense (\$190,000), increased labor expense (\$102,000) and increased transportation expense (\$46,000).

For the nine months ended March 31, 2010, operation and maintenance expense decreased \$1,128,000 (10%). The decrease was primarily due to an inventory adjustment for our gas in storage (\$1,350,000, as further discussed in Note 11 of the Notes to Consolidated Financial Statements) recorded in the prior year and decreased uncollectible expense (\$723,000) partially offset by increased employee benefit expense (\$398,000) and increased professional services expense (\$213,000).

For the twelve months ended March 31, 2010, operation and maintenance expense decreased \$2,072,000 (13%). The decrease was primarily due to an inventory adjustment for our gas in storage (\$1,350,000, as further discussed in Note 11 of the Notes to Consolidated Financial Statements) recorded in the prior year and decreased uncollectible expense (\$889,000) partially offset by increased employee benefit expense (\$415,000).

Taxes Other Than Income Taxes

For the nine and twelve months ended March 31, 2010, taxes other than income taxes increased \$149,000 (11%) and \$216,000 (12%), respectively due to increases in property tax expense.

Other Income and Deductions, Net

For the nine and twelve months ended March 31, 2010, other income and deductions, net increased \$220,000 (220%) and \$227,000 (428%), respectively. The increases were due to increases in the cash surrender value of officers’ life insurance as well as increases in the fair value of the supplemental retirement plan. The increases in the fair value of the supplemental retirement plan were offset by increased operating expenses resulting from a corresponding increase in the liability of the plan.

Interest Charges

For the nine months ended March 31, 2010, interest charges decreased \$342,000 (10%) due to decreased borrowings on our bank line of credit and decreases in the average interest rate on our bank line of credit.

Income Tax Expense

For the twelve months ended March 31, 2010, income tax expense decreased \$528,000 (16%) as a result of decreased net income before income taxes.

Basic and Diluted Earnings Per Common Share

For the three, nine and twelve months ended March 31, 2010 and 2009, our basic earnings per common share changed as a result of changes in net income and an increase in the number of our common shares outstanding. We increased our number of common shares outstanding as a result of shares issued through our Dividend Reinvestment and Stock Purchase Plan.

We have no potentially dilutive securities. As a result, our basic earnings per common share and our diluted earnings per common share are the same.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We purchase our gas supply through a combination of spot market gas purchases and forward gas purchases. The price of spot market gas is based on the market price at the time of delivery. The price we pay for our natural gas supply acquired under our forward gas purchase contracts, however, is fixed prior to the delivery of the gas. Additionally, we inject some of our gas purchases into gas storage facilities in the non-heating months and withdraw this gas from storage for delivery to customers during the heating season. For our regulated business, we have minimal price risk resulting from these forward gas purchase and storage arrangements because we are permitted to pass these gas costs on to our regulated customers through the gas cost recovery clause, approved quarterly by the Kentucky Public Service Commission. Historically the Kentucky Public Service Commission has allowed us to recover all of our gas costs through the gas cost recovery mechanism. However, as noted in Note 9 of Notes to Consolidated Financial Statements, our proposed gas cost recovery rate to become effective April 26, 2010 was suspended until September 25, 2010 pending further proceedings to determine the reasonableness of the rates. We are unable to predict the outcome of the proceeding.

Price risk for the non-regulated business is mitigated by efforts to balance supply and demand. However, there are greater risks in the non-regulated segment because of the practical limitations on the ability to perfectly predict demand. In addition, we are exposed to price risk resulting from changes in the market price of gas on uncommitted gas volumes of our non-regulated companies.

None of our gas contracts are accounted for using the fair value method of accounting. While some of our gas purchase and gas sales contracts meet the definition of a derivative, we have designated these contracts as "normal purchases" and "normal sales" under Accounting Standards Codification Topic 815, entitled Derivatives and Hedging.

When we have a balance outstanding on our variable rate bank line of credit, we are exposed to risk resulting from changes in interest rates. The interest rate on our bank line of credit with Branch Banking and Trust Company is benchmarked to the monthly London Interbank Offered Rate. As of March 31, 2010, we had no balance outstanding on our bank line of credit. As of June 30, 2009 and March 31, 2009, the balances on our bank line of credit were \$3,653,000 and \$10,658,000, respectively. The weighted average interest rates on our bank line of credit were 1.8% and 1.3% on June 30, 2009 and March 31, 2009, respectively. Based on the amounts of our outstanding bank line of credit on June 30, 2009 and March 31, 2009, a one percent (one hundred basis point) increase in our average interest rates would result in decreases in our annual pre-tax net income of \$37,000 and \$107,000, respectively.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure controls and procedures are our controls and other procedures that are designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 (“Exchange Act”) is recorded, processed, summarized, and reported within the time periods specified by the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of March 31, 2010, and, based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended March 31, 2010 and found no changes that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not a party to any legal proceedings that are expected to have a materially adverse impact on our liquidity, financial condition or results of operations.

ITEM 1A. RISK FACTORS

No material changes.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. REMOVED AND RESERVED

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DATE: May 5, 2010

/s/**Glenn R. Jennings**

Glenn R. Jennings
Chairman of the Board, President and Chief
Executive Officer
(Duly Authorized Officer)

/s/**John B. Brown**

John B. Brown
Chief Financial Officer, Treasurer and Secretary
(Principal Financial Officer and Principal
Accounting Officer)

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Glenn R. Jennings, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Delta Natural Gas Company, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

DATE: May 5, 2010

/s/Glenn R. Jennings

Glenn R. Jennings
Chairman of the Board, President and Chief
Executive Officer
(Duly Authorized Officer)

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, John B. Brown, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Delta Natural Gas Company, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

DATE: May 5, 2010

/s/John B. Brown

John B. Brown
Chief Financial Officer, Treasurer and Secretary
(Principal Financial Officer and Principal
Accounting Officer)

**CERTIFICATION OF THE
CHIEF EXECUTIVE OFFICER PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Delta Natural Gas Company, Inc. on Form 10-Q for the period ending March 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Glenn R. Jennings, Chairman of the Board, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Delta Natural Gas Company, Inc.

DATE: May 5, 2010

/s/Glenn R. Jennings

Glenn R. Jennings
Chairman of the Board, President and Chief
Executive Officer
(Duly Authorized Officer)

**CERTIFICATION OF THE
CHIEF FINANCIAL OFFICER PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Delta Natural Gas Company, Inc. on Form 10-Q for the period ending March 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John B. Brown, Chief Financial Officer, Treasurer and Secretary of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Delta Natural Gas Company, Inc.

DATE: May 5, 2010

/s/John B. Brown

John B. Brown
Chief Financial Officer, Treasurer and Secretary
(Principal Financial Officer and Principal
Accounting Officer)