

PETROLEUM DEVELOPMENT CORP
Form 10-Q
August 09, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D. C. 20549

FORM 10-Q

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2007

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 Number 000-07246

PETROLEUM DEVELOPMENT CORPORATION
(Exact name of registrant as specified in its charter)

Nevada
(State of incorporation)

95-2636730
(I.R.S. Employer Identification No.)

120 Genesis Boulevard
Bridgeport, West Virginia 26330
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code: (304) 842-3597

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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: 14,898,285 shares of the Company's Common Stock (\$.01 par value) were outstanding as of July 31, 2007.

PETROLEUM DEVELOPMENT CORPORATION

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Condensed Consolidated Balance Sheets

(in thousands, except share data)

	June 30, 2007	December 31, 2006*
Assets		
Current assets:		
Cash and cash equivalents	\$ 21,586	\$ 194,326
Restricted cash - current	14,903	519
Accounts receivable, net	47,550	42,600
Accounts receivable - affiliates	13,906	9,235
Inventories	5,775	3,345
Fair value of derivatives	12,785	15,012
Other current assets	15,650	5,977
Total current assets	132,155	271,014
Properties and equipment, net	698,525	394,217
Restricted cash - long term	1,295	192,451
Other assets	4,708	26,605
Total assets	\$ 836,683	\$ 884,287
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	\$ 81,258	\$ 67,675
Short term debt	-	20,000
Production tax liability	14,271	11,497
Other accrued expenses	10,887	9,685
Accounts payable - affiliates	8,943	7,595
Deferred gain on sale of leaseholds	-	8,000
Federal and state income taxes payable	2,145	28,698
Fair value of derivatives	3,692	2,545
Advances for future drilling contracts	3,526	54,772
Funds held for future distribution	44,090	31,367
Total current liabilities	168,812	241,834
Long-term debt	124,000	117,000
Deferred gain on sale of leaseholds	-	17,600
Other liabilities	17,810	19,400
Deferred income taxes	126,557	116,393
Asset retirement obligation	17,459	11,916
Total liabilities	454,638	524,143
Commitments and contingencies		
Minority interest in consolidated limited liability company	792	-
Shareholders' equity:		

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Common stock, shares issued: 14,893,070 in 2007 and 14,834,871 in 2006

	149	148
Additional paid-in capital	908	64
Retained earnings	380,386	360,102
Treasury shares, at cost: 5,158 in 2007 and 4,706 in 2006	(190)	(170)
Total shareholders' equity	381,253	360,144
Total liabilities and shareholders' equity	\$ 836,683	\$ 884,287

**Derived from audited 2006 balance sheet.*

See accompanying notes to condensed consolidated financial statements.

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Condensed Consolidated Statements of Income

(unaudited; in thousands except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006 <i>Revised*</i>	2007	2006 <i>Revised*</i>
Revenues:				
Oil and gas sales	\$ 39,246	\$ 27,992	\$ 73,262	\$ 56,324
Sales from natural gas marketing activities	29,924	29,129	51,911	71,071
Oil and gas well drilling operations	1,739	3,745	5,769	9,023
Well operations and pipeline income	1,292	2,486	4,590	4,776
Oil and gas price risk management, net	3,742	1,370	(1,903)	6,295
Other	2	21	228	24
Total revenues	75,945	64,743	133,857	147,513
Costs and expenses:				
Oil and gas production and well operations cost	11,628	6,830	20,663	13,779
Cost of natural gas marketing activities	28,780	28,471	50,292	70,251
Cost of oil and gas well drilling operations	246	3,278	810	7,490
Exploration expense	6,780	1,898	9,458	3,106
General and administrative expense	6,886	5,102	14,310	8,821
Depreciation, depletion and amortization	17,429	7,605	30,503	14,192
Total costs and expenses	71,749	53,184	126,036	117,639
Gain on sale of leaseholds	25,600	-	25,600	-
Income from operations	29,796	11,559	33,421	29,874
Interest income	454	349	1,597	741
Interest expense	(1,450)	(436)	(2,281)	(788)
Income before income taxes	28,800	11,472	32,737	29,827
Income taxes	10,749	4,192	12,185	10,902
Net income	\$ 18,051	\$ 7,280	\$ 20,552	\$ 18,925
Earnings per common share:				
Basic	\$ 1.22	\$ 0.45	\$ 1.40	\$ 1.18
Diluted	\$ 1.21	\$ 0.45	\$ 1.38	\$ 1.17
Weighted average common shares outstanding:				
Basic	14,740	16,058	14,730	16,086
Diluted	14,860	16,134	14,851	16,164

*See Note 1.

See accompanying notes to condensed consolidated financial statements.

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Condensed Consolidated Statements of Cash Flows

(unaudited, in thousands)

	Six Months Ended June 30,	
	2007	2006 <i>Revised*</i>
Cash flows from operating activities:		
Net income	\$ 20,552	\$ 18,925
Adjustments to net income to reconcile to cash used in operating activities:		
Deferred income taxes	5,707	1,619
Depreciation, depletion and amortization	30,503	14,192
Accretion of asset retirement obligation	469	249
Exploratory dry hole costs	194	1,903
Gain from sale of assets	-	(12)
Gain from sale of leaseholds	(25,600)	-
Expired and abandoned leases	1,193	16
Stock-based compensation	1,024	666
Unrealized loss (gain) on derivative transactions	2,523	(4,562)
Changes in assets and liabilities related to operations:		
(Decrease) increase in current assets	(34,825)	10,006
Increase (decrease) in other assets	223	(7)
Decrease in current liabilities	(74,468)	(58,721)
(Decrease) increase in other liabilities	(3,880)	1,783
Net cash used in operating activities	(76,385)	(13,943)
Cash flows from investing activities:		
Capital expenditures	(73,122)	(57,041)
Acquisitions	(201,594)	-
Decrease in restricted cash for property acquisition	191,155	-
Proceeds from sale of assets	-	14
Proceeds from sale of leases to partnerships	385	782
Net cash used in investing activities	(83,176)	(56,245)
Cash flows from financing activities:		
Proceeds from debt	162,000	136,000
Repayment of debt	(175,000)	(91,000)
Payment of debt issuance costs	-	(22)
Proceeds from exercise of stock options	164	31
Purchase of treasury stock	(343)	(10,153)
Net cash (used in) provided by financing activities	(13,179)	34,856
Net decrease in cash and cash equivalents	(172,740)	(35,332)

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Cash and cash equivalents, beginning of period	194,326	90,110
Cash and cash equivalents, end of period	\$ 21,586	\$ 54,778

**See Note 1.*

See accompanying notes to condensed consolidated financial statements.

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Petroleum Development Corporation

Notes to Condensed Consolidated Financial Statements

June 30, 2007

(*unaudited*)

1. GENERAL

Petroleum Development Corporation ("PDC"), together with its consolidated entities (the "Company") is an independent energy company engaged primarily in the exploration, development, production and marketing of oil and natural gas. Since it began oil and natural gas operations in 1969, the Company has grown primarily through exploration and development activities, the acquisition of producing oil and natural gas wells and the expansion of its natural gas marketing activities.

The accompanying interim condensed consolidated financial statements include the accounts of PDC, its wholly owned subsidiaries and WWWV, LLC, an entity in which the Company has a controlling financial interest (see Note 6). All material intercompany accounts and transactions have been eliminated in consolidation. Minority interest in earnings and ownership has been recorded for the percentage of the LLC not owned by PDC for each of the applicable periods. The Company accounts for its investment in interests in oil and natural gas limited partnerships under the proportionate consolidation method. Accordingly, the Company's condensed consolidated financial statements include its pro rata share of assets, liabilities, revenues and expenses of the limited partnerships in which it participates. The Company's proportionate share of all significant transactions between the Company and the limited partnerships is eliminated.

The accompanying interim condensed consolidated financial statements have been prepared without audit in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission ("SEC"). Accordingly, pursuant to such rules and regulations, certain notes and other financial information included in audited financial statements have been condensed or omitted. In the opinion of management, the accompanying interim condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company's financial position, results of operations and cash flows for the periods presented. The interim results of operations for the six months ended June 30, 2007, and the interim cash flows for the same interim period, are not necessarily indicative of the results to be expected for the full year or any other future period.

The accompanying interim condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the SEC on May 23, 2007 ("2006 Form 10-K").

Items Affecting Comparability

Reclassifications have been made to the income statement data presented for the three and six months ended June 30, 2006, to conform to the current year presentation and to correct the prior period presentation. These reclassifications had no impact on reported net earnings, earnings per share, shareholders' equity or total net cash flows. Oil and gas price risk management gains of \$1.4 million and \$6.3 million for the three and six months ended June 30, 2006, respectively, have been reclassified from non-operating gains to a component of revenues. These reclassifications and all other reclassifications are reflected in the revised amounts for three and six months ended June 30, 2006.

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As described in Note 1 to the Consolidated Financial Statements of the Company's 2006 Form 10-K, during the fourth quarter of 2006, the Company adopted SEC Staff Accounting Bulletin ("SAB") No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. In accordance with SAB No. 108, the Company adjusted its opening financial position for 2006 by the cumulative effect of immaterial prior period misstatements. In connection with the adoption of SAB No. 108, the Company determined that certain similar errors were included in its results of operations for each of the first three quarters of 2006. The Company revised the data presented in Note 19, Quarterly Financial Data, to the Consolidated Financial Statements of its 2006 Form 10-K and revised the prior year quarterly financial statements included herein to reflect the correction of those immaterial misstatements.

The following table presents the income statement for the three month and six month periods ended June 30, 2006, as previously presented in the Company's Form 10-Q for the related period, adjusted to reflect reclassifications to conform to current presentation and to correct previous presentation, and as revised to reflect the correction of prior period immaterial misstatements.

	Three Months Ended June 30, 2006			Six Months Ended June 30, 2006		
	Previously Reported	Reclassified (1)	Revised (2)	Previously Reported	Reclassified (1)	Revised (2)
<i>(in thousands, except per share data)</i>						
Revenues:						
Oil and gas sales	\$ 27,267	\$ 27,267	\$ 27,992	\$ 56,476	\$ 56,475	\$ 56,324
Sales from natural gas marketing activities	29,129	29,129	29,129	71,071	71,071	71,071
Oil and gas well drilling operations	3,745	3,745	3,745	9,023	9,023	9,023
Well operations and pipeline income	2,486	2,486	2,486	4,776	4,776	4,776
Oil and gas price risk management, net	-	1,367	1,370	-	5,802	6,295
Other	364	21	21	754	24	24
Total revenues	62,991	64,015	64,743	142,100	147,171	147,513
Costs and expenses:						
Oil and gas production and well operations cost	6,313	6,770	6,830	13,417	14,031	13,779
Cost of natural gas marketing activities	28,462	28,462	28,471	70,238	70,237	70,251
Cost of oil and gas well drilling operations	3,474	3,159	3,278	7,630	7,240	7,490

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Exploration expense	1,657	1,657	1,898	2,795	2,820	3,106
General and administrative expense	4,667	4,667	5,102	8,647	8,648	8,821
Depreciation, depletion and amortization	7,617	7,617	7,605	14,233	14,233	14,192
Total costs and expenses	52,190	52,332	53,184	116,960	117,209	117,639
Income from operations	10,801	11,683	11,559	25,140	29,962	29,874
Interest income	-	343	349	-	731	741
Interest expense	(267)	(125)	(436)	(447)	(198)	(788)
Oil and gas price risk management, net	1,367	-	-	5,802	-	-
Income before income taxes	11,901	11,901	11,472	30,495	30,495	29,827
Income taxes	4,351	4,351	4,192	11,147	11,147	10,902
Net income	\$ 7,550	\$ 7,550	\$ 7,280	\$ 19,348	\$ 19,348	\$ 18,925
Basic earnings per common share	\$ 0.47	\$ 0.47	\$ 0.45	\$ 1.20	\$ 1.20	\$ 1.18
Diluted earnings per share	\$ 0.47	\$ 0.47	\$ 0.45	\$ 1.20	\$ 1.20	\$ 1.17

(1) As previously reported in the corresponding Form 10-Q, reclassified to conform to current year presentation and to correct previous presentation.

(2) Reflects the impact of certain immaterial errors on the results previously reported in 2006.

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The reclassifications and revisions discussed above have no impact on the condensed consolidated balance sheets presented herein, nor do they result in changes to the net decrease in cash and cash equivalents previously presented in the Form 10-Q for the six months ended June 30, 2006. However, certain line items within cash flows from operating activities and one line item within cash flow from investing activities for the six months ended June 30, 2006, have been adjusted herein to reflect the impact of the income statement revisions. Revised line items are as follows:

	Six Months Ended June 30, 2006	
	Previously Reported	Revised ⁽¹⁾
Certain statement of cash flow line items:	<i>(in thousands)</i>	
Net income	\$ 19,348	\$ 18,925
Deferred income taxes	1,671	1,619
Depreciation, depletion and amortization	14,233	14,192
Exploratory dry hole cost	1,617	1,903
Unrealized gain on derivative transactions	(4,096)	(4,562)
Decrease in current assets	9,645	10,006
Decrease in other current liabilities	(58,067)	(58,721)
Increase in other liabilities	1,649	1,783
Net cash used in operating activities	(13,088)	(13,943)
Capital expenditures	(57,896)	(57,041)
Net cash used in investing activities	(57,100)	(56,245)
Net decrease in cash and cash equivalents	(35,332)	(35,332)

⁽¹⁾ Reflects the impact of certain immaterial errors on the results previously reported in 2006.

2. RECENT ACCOUNTING STANDARDS**Recently Adopted Accounting Standards**

In June 2006, the Financial Accounting Standards Board ("FASB") issued Emerging Issues Task Force ("EITF") No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That Is, Gross versus Net Presentation)*. EITF 06-3 addresses the income statement presentation of any tax collected from customers and remitted to a government authority and concludes that the presentation of taxes on either a gross basis or a net basis is an accounting policy decision that should be disclosed pursuant to Accounting Principles Board ("APB") No. 22, *Disclosures of Accounting Policies*. For taxes that are reported on a gross basis (included in revenues and costs), EITF 06-3 requires disclosure of the amounts of those taxes in interim and annual financial statements, if those amounts are significant. EITF 06-3 became effective for interim and annual reporting periods beginning after December 15, 2006. The adoption of the standard, effective January 1, 2007, did not have a significant impact on the accompanying condensed consolidated financial statements. The Company's existing accounting policy, which was not changed upon the adoption of EITF 06-3, is to present taxes within the scope of EITF 06-3 on a net basis.

In July 2006, the FASB issued FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109*, which prescribes a comprehensive model for accounting for uncertainty in tax

positions. FIN No. 48 provides that the tax effects from an uncertain tax position can be recognized in the financial statements, only if the position is more likely than not of being sustained on audit by the Internal Revenue Service ("IRS"), based on the technical merits of the position. The provisions of FIN No. 48 became effective for the Company on January 1, 2007. The cumulative effect of applying the provisions of FIN No. 48 has been accounted for as an adjustment to retained earnings in the first quarter of 2007. The adoption of FIN No. 48 resulted in a \$0.3 million cumulative effect adjustment (see Note 5 for further discussion).

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In May 2007, the FASB issued FASB Staff Position FIN No. 48-1, *Definition of Settlement in FASB Interpretation No. 48* ("FIN No. 48-1"). FIN No. 48-1 amends FIN No. 48 to provide guidance on how an entity should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The term "effectively settled" replaces the term "ultimately settled" when used to describe recognition, and the terms "settlement" or "settled" replace the terms "ultimate settlement" or "ultimately settled" when used to describe measurement of a tax position under FIN No. 48. FIN No. 48-1 clarifies that a tax position can be effectively settled upon the completion of an examination by a taxing authority without being legally extinguished. For tax positions considered effectively settled, an entity would recognize the full amount of tax benefit, even if the tax position is not considered more likely than not to be sustained based solely on the basis of its technical merits and the statute of limitations remains open. The adoption of FIN No. 48-1, effective January 1, 2007, did not have an impact on the accompanying condensed consolidated financial statements.

Recently Issued Accounting Standards

In September 2006, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 157, *Accounting for Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value within generally accepted accounting principles and expands required disclosure about fair value measurements. SFAS No. 157 does not expand the use of fair value in any new circumstances. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is evaluating the impact that this new standard will have, if any, on its consolidated financial statements when adopted in 2008.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to choose to measure, at fair value, many financial instruments and certain other items that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The statement will be effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is evaluating the impact of adopting SFAS No. 159 in its consolidated financial statements when it is adopted in 2008.

In April 2007, the FASB issued FSP FIN No. 39-1, *Amendment of FASB Interpretation No. 39* ("FIN No. 39-1"), to amend certain portions of Interpretation 39. FIN No. 39-1 replaces the terms "conditional contracts" and "exchange contracts" in Interpretation 39 with the term "derivative instruments" as defined in Statement 133. FIN No. 39-1 also amends Interpretation 39 to allow for the offsetting of fair value amounts for the right to reclaim cash collateral or receivable, or the obligation to return cash collateral or payable, arising from the same master netting arrangement as the derivative instruments. FIN No. 39-1 applies to fiscal years beginning after November 15, 2007, with early adoption permitted. The Company is currently in the process of evaluating the impact that FIN No. 39-1 will have, if any, on its consolidated financial statements when adopted in 2008.

3. ACQUISITIONS

Acquisition of Internal Revenue Code Section 1031 – Like-Kind Exchange Properties

During the first quarter of 2007, the Company completed its acquisitions of suitable like-kind properties in accordance with the like-kind exchange ("LKE") agreement it entered into in connection with its sale of undeveloped leaseholds located in Grand Valley Field, Garfield County, Colorado in July 2006. The Company acquired for cash qualifying oil and gas properties totaling \$188.9 million, including costs of acquisition, as described below.

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EXCO Properties. On January 5, 2007, the Company completed its purchase of producing properties and undeveloped drilling locations and acreage in the Wattenberg Field area of the DJ Basin, Colorado from EXCO Resources Inc., an unaffiliated party. The acquisition included substantially all of EXCO's assets in the area and encompassed 144 oil and natural gas wells (approximating 25.5 Bcfe proved developed reserves as of December 31, 2005) and 8,160 acres of leasehold. The wells and leases acquired are located in Weld, Adams, Larimer, and Broomfield Counties, Colorado. The Company operates the assets and holds a majority working interest in the properties.

Company-Sponsored Partnerships. On January 10, 2007, the Company completed the purchase of the remaining working interests in 44 Company-sponsored partnerships. The transaction resulted in an increase in the Company's ownership in 718 gross wells (423 net wells) that are currently operated by the Company. The wells are located primarily in the Appalachian Basin and Michigan.

The following table presents the adjusted preliminary purchase price for each of the acquisitions described above as of June 30, 2007.

	EXCO	Partnerships
	<i>(in thousands)</i>	
Cash consideration paid	\$ 128,672	\$ 57,776
Plus: direct costs of acquisition	1,662	1,664
Less: acquisition cost adjustments	(119)	(2,792)
Total preliminary acquisition cost	\$ 130,215	\$ 56,648

The following table presents, as of the respective date of acquisition, the preliminary allocations of the purchase prices based on estimates of fair value.

	EXCO	Partnerships
	<i>(in thousands)</i>	
Current assets acquired	\$ 91	\$ -
Proved oil and gas properties	117,425	46,870
Unproved oil and gas properties	14,960	13,273
Asset retirement obligation	(748)	(3,495)
Other liabilities assumed	(1,513)	-
Preliminary acquisition cost	\$ 130,215	\$ 56,648

The assessment of fair value of proved oil and gas properties acquired was based primarily on projections of expected discounted future cash flows of acquired oil and natural gas reserves. To compensate for the inherent risk of estimating and valuing unproved properties, the discounted future net revenues of probable reserves were reduced by additional risk-weighting factors in that valuation. The purchase price allocations are preliminary, subject to fair value appraisals and evaluations of the assets acquired. The amounts are subject to change as additional information becomes available and is assessed by the Company.

Other. In January 2007, the Company acquired from unaffiliated parties other like-kind undeveloped leaseholds in Erath County, Texas for \$2.1 million, including costs of acquisition. Acreage in this area is prospective for development of oil and natural gas reserves in the Barnett Shale.

Index***Other Acquisitions***

Unioil. On December 6, 2006, the Company completed a cash tender offer and purchased approximately 95.5% or 9,112,750 shares of the outstanding common stock of Unioil, an independent energy company with properties in northern Colorado and southern Wyoming. The acquisition of more than 90% of the outstanding shares of common stock allowed the Company to effect a short-form merger of Unioil and a wholly owned subsidiary of the Company, resulting in the acquisition of the remaining 428,719 shares of Unioil. Each share of Unioil common stock not tendered through the offer was converted into the right to receive \$1.91 in cash, the same consideration paid for shares in the tender offer. The Company paid \$18.6 million, including \$0.4 million of direct acquisition costs, for 100% of Unioil's outstanding common stock.

The assessment of the fair values of oil and gas properties acquired was based primarily on projections of expected future net cash flows, discounted to present value. The preliminary allocation of acquisition cost included \$6.8 million in goodwill, which was re-allocated to properties and equipment in the first quarter of 2007 as part of the Company's ongoing process of finalizing the preliminary allocation of the purchase price. As a result of this reclassification, the deferred tax liabilities increased and thus increased property and equipment. This increase was approximately \$4.2 million. The purchase price allocation is preliminary, subject to completing the evaluation of proved and unproved oil and gas properties. These amounts are subject to change as additional information becomes available and is assessed by the Company.

Other. On February 22, 2007, the Company acquired, from an unaffiliated party, 28 producing wells and associated undeveloped acreage located in Colorado (Wattenberg Field) for a purchase price of \$12 million, which was allocated to oil and gas properties.

Pro Forma Financial Information

The results of operations for all of the above acquisitions have been included in the condensed consolidated financial statements from the date of acquisition. The pro forma effect of the inclusion of the results of operations for all of the above acquisitions, individually and in the aggregate, in the Company's condensed consolidated statement of income for the six months ended June 30, 2007, was not material.

The following unaudited pro forma financial information presents a summary of the Company's consolidated results of operations for the three and six months ended June 30, 2006, assuming the acquisitions of the EXCO properties and Company-sponsored partnerships had been completed as of January 1, 2006, including adjustments to reflect the allocation of the purchase price to the acquired net assets. The pro forma effect of the inclusion of the results of operations for all of the other acquisitions described above, individually and in the aggregate, was not material.

	June 30, 2006	
	Three Months Ended	Six Months Ended
	<i>(in thousands, except per share data)</i>	
Total revenues	\$ 70,913	\$ 161,620
Net income	8,334	22,366
Earnings per common share:		
Basic	\$ 0.52	\$ 1.39
Diluted	\$ 0.52	\$ 1.38

The pro forma results of operations are not necessarily indicative of what the Company's results of operations would have been had the EXCO properties and Company-sponsored partnerships been acquired at the beginning of the period indicated, nor does it purport to represent results of operations for any future periods.

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4. RESTRICTED CASH

In July 2006, the Company established a trust in the amount of \$300 million with a qualified intermediary in conjunction with its sale of undeveloped leaseholds and corresponding LKE agreement. As of December 31, 2006, \$300 million remained in the trust, with \$109 million reflected in cash and cash equivalents as a current asset in the condensed consolidated balance sheet and the remaining \$191.5 million reflected as restricted cash - long term. The \$191.5 million represents the amounts paid in January 2007 for the acquisition of oil and gas properties qualifying for LKE treatment which are included in oil and gas properties at June 30, 2007.

In June 2007, the Company funded an escrow account in the amount of \$14.1 million for amounts due to the limited partners of the Company sponsored drilling partnership as a result of the Company over withholding estimated production taxes in years prior to 2007 and is included in restricted cash, current, in the condensed consolidated balance sheet as of June 30, 2007.

5. INCOME TAXES

Effective January 1, 2007, the Company adopted FIN No. 48, which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement 109, *Accounting for Income Taxes*, by prescribing the minimum recognition threshold and measurement attribute a tax position taken or expected to be taken on a tax return is required to meet before being recognized in the financial statements. The Company recorded a \$0.3 million reduction in retained earnings at January 1, 2007, to recognize the cumulative effect of the adoption of FIN No. 48. This amount represents the total amount of interest on unrecognized tax benefits as of the date of adoption. As of January 1, 2007, unrecognized tax benefits amounted to \$1 million and are included in federal and state income taxes payable in the condensed consolidated balance sheet. None of the unrecognized tax benefits relate to a position that, if recognized, will impact the Company's effective tax rate. Due to the variable nature of the income or expense to which the uncertain tax position relates, the Company, as of June 30, 2007, is unable to predict whether the unrecognized tax benefit will significantly increase or decrease in the next twelve months.

The Company, as a matter of accounting policy, recognizes interest and penalties related to unrecognized tax benefits, if applicable, in income tax expense in the condensed consolidated statements of income. During the three and six months ended June 30, 2007, there was no material change to the amount of interest recorded on unrecognized tax benefits. Accruals for interest on unrecognized tax benefits totaled \$0.3 million at June 30, 2007, which are included in federal and state income taxes payable in the condensed consolidated balance sheet. There were no accruals for penalties on unrecognized tax benefits at January 1, 2007, or during the three and six months ended June 30, 2007.

At June 30, 2007, the Company's federal income tax returns were closed through the 2002 tax year and there are no outstanding tax controversies with any taxing authorities regarding these prior tax years. Additionally, at June 30, 2007, the IRS was examining the Company's 2003 and 2004 tax years. Subsequently, the Company reached final settlement of this examination with the IRS and the examination was officially concluded and the revenue agent's report was signed on July 31, 2007. The impact of the settlement will be recorded in the third quarter and is currently not expected to have a material effect on the Company's effective tax rate.

State and other income tax returns are generally subject to examination for a period of three to five years after the filing of the respective returns. The state impact of any amended federal returns, whether or not pursuant to IRS examination changes or pursuant to Company voluntary changes, remains subject to examination by various states for a period of up to one year after formal notification of such amendments to the states. The Company currently has no state income tax returns in the process of examination or administrative appeal.

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The Company filed its 2004 state income tax returns in June 2007, which begins the statute of limitations for examination and adjustment. The Company is currently delinquent in its 2005 federal and state income tax filings and plans to file these returns by mid September 2007. Accordingly, the normal federal and state statute of limitations for the 2005 tax year will not begin until the return filing dates.

6. MINORITY INTEREST IN CONSOLIDATED LIMITED LIABILITY COMPANY

On May 8, 2007, the Company contributed \$0.8 million for a 50% interest in WWWV, LLC ("LLC"), a limited liability company for which the Company serves as the managing member. One-sixth of the entity is owned by the Chief Executive Officer of the Company, who paid the same unit price for his interest as was paid by the Company and unrelated third parties for such interest in the LLC. The LLC's only asset is an aircraft and it was formed for the purpose of owning and operating the aircraft.

The minority interest portion of pre-tax expense incurred by and belonging to the minority interest holders of the consolidated limited liability company is not material.

7. EARNINGS PER SHARE

A reconciliation of basic and diluted earnings per common share is as follows:

	Three Months Ended June 30, 2007		Six Months Ended June 30, 2007		Six Months Ended June 30, 2006			
	(in thousands, except per share data)							
Weighted average common shares outstanding	14,740		16,058		14,730		16,086	
Dilutive effect of share-based compensation:								
Unamortized portion of restricted stock	69		13		65		13	
Stock options	46		63		51		65	
Non employee director deferred compensation	5		-		5		-	
Weighted average common and common equivalent shares outstanding	14,860		16,134		14,851		16,164	
Net income	\$	18,051	\$	7,280	\$	20,552	\$	18,925
Basic earnings per common share	\$	1.22	\$	0.45	\$	1.40	\$	1.18
Diluted earnings per common share	\$	1.21	\$	0.45	\$	1.38	\$	1.17

Options with an exercise price exceeding the average price of the underlying securities are not considered to be dilutive and are not included in the calculation of the denominator for diluted earnings per share. There were no anti-dilutive options for the three and six months ended June 30, 2007 or 2006.

8. STOCK-BASED COMPENSATION

The Company maintains a long-term equity compensation plan for directors, officers and certain key employees of the Company. In accordance with the plan, awards may be issued in the form of stock options, stock appreciation rights,

restricted stock or performance shares.

The following table provides a summary of the impact of the Company's stock based compensation plans on its results of operations for the periods presented.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	<i>(in thousands)</i>			
Total share-based compensation expense	\$ 541	\$ 458	\$ 1,024	\$ 666
Income tax benefit	(202)	(167)	(381)	(243)
Net income impact	\$ 339	\$ 291	\$ 643	\$ 423

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Stock Option Awards. The Company granted stock options in previous years under several stock compensation plans. Outstanding options expire ten years from the date of grant and become exercisable ratably over a four year period. The Company did not grant any stock option awards for the six months ended June 30, 2007. The weighted average fair value per share of the options granted during the six months ended June 30, 2006, as computed using the Black-Scholes pricing model was \$18.92. The weighted average assumptions used to estimate these fair values were as follows:

	Six Months Ended June 30, 2006
Expected Volatility	39.5%
Expected term (in years)	5.9
Risk-free interest rate	4.3%

Expected volatilities are based on the Company's historical volatility. The expected life of an award is estimated using historical exercise behavior data. The risk-free interest rate is based on the U.S. Treasury yields in effect at the time of grant and extrapolated to approximate the expected life of the award. The Company does not expect to pay cash dividends, nor does it expect to declare cash dividends in the foreseeable future.

The following table provides a summary of the Company's stock option award activity for the six months ended June 30, 2007:

	Number of Shares Underlying Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding at December 31, 2006	89,567	\$ 21.36	5.6	\$ 2.0
Exercised	(33,000)	4.95	-	1.5
Outstanding at June 30, 2007	56,567	30.92	6.4	0.9
Vested and expected to vest at June 30, 2007	52,808	29.93	6.3	0.9
Exercisable at June 30, 2007	29,529	20.46	4.6	0.8

Total unrecognized stock-based compensation cost related to stock options, net of estimated forfeitures, was \$0.4 million as of June 30, 2007. This cost is expected to be recognized over a weighted average period of 2.4 years.

Restricted and Performance Share Awards. During the six months ended June 30, 2007, the Company awarded 33,345 restricted shares with a weighted average grant date fair value of \$50.96 per share and 31,972 performance vesting (market based) shares of restricted stock with a weighted average grant date fair value of \$36.07 per share. The fair value of the restricted awards, excluding the market based performance shares, is amortized over the requisite service period, which for the Company is ratably over four years from the date of grant. The market based performance shares vest only upon the achievement of certain per share price thresholds and continuous employment during the vesting period. The weighted average grant date fair value of each performance share was computed using the Monte Carlo pricing model and the following weighted average assumptions:

Expected term of award	3 years
Risk-free interest rate	4.7%
Volatility	44.0%

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The following table provides a summary of the Company's restricted and performance share awards activity for the six months ended June 30, 2007:

	Shares	Weighted Average Grant-Date Fair Value
Non-vested at December 31, 2006	131,730	\$ 39.87
Granted	65,317	43.67
Vested	(27,176)	38.15
Forfeited	(1,392)	40.29
Non-vested at June 30, 2007	168,479	41.62

The total compensation cost related to non-vested and expected to vest awards not yet recognized as of June 30, 2007, was \$4.9 million. The cost is expected to be recognized over a weighted-average period of 3.1 years.

9. PROPERTIES AND EQUIPMENT

	June 30, 2007	December 31, 2006
	<i>(in thousands)</i>	
Properties and equipment, net:		
Oil and gas properties (successful efforts method of accounting)	\$ 822,734	\$ 500,506
Pipelines and related facilities ⁽¹⁾	18,377	12,673
Transportation and other equipment ⁽²⁾	17,146	7,870
Land and buildings	11,862	11,620
Construction in progress ⁽³⁾	2,166	4,801
	872,285	537,470
Less accumulated depreciation, depletion and amortization	173,760	143,253
	\$ 698,525	\$ 394,217

⁽¹⁾ At June 30, 2007, includes \$2.7 million related to additional compressors and upgraded pipeline facilities in the Company's Piceance Basin production operations, which was placed in service in June 2007.

⁽²⁾ At June 30, 2007, includes \$5.1 million related to the Garden Gulch road, which was placed in service in May 2007. At December 31, 2006, construction in progress included \$3.6 million related to the Garden Gulch road.

⁽³⁾ At June 30, 2007, includes costs primarily related to a new integrated oil and gas accounting software system.

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The following table identifies the capitalized exploratory well costs that are pending determination of proved reserves and are included in oil and gas properties in the accompanying condensed consolidated balance sheets in accordance with FASB Staff Position No. 19-1, *Accounting for Suspended Well Costs*.

	Amount (in thousands)	Number of Wells
Beginning balance at December 31, 2006	\$ 765	1
Additions to capitalized exploratory well costs pending the determination of proved reserves	1,992	3
Reclassifications to wells, facilities and equipment based on the determination of proved reserves	(879)	(1)
Capitalized exploratory well costs charged to expense	(765)	(1)
Ending balance at June 30, 2007	\$ 1,113	2

As of June 30, 2007, neither of the two wells awaiting the determination of proved reserves has been capitalized for a period greater than one year.

10. ASSET RETIREMENT OBLIGATION

Changes in carrying amounts of the asset retirement obligations associated with the Company's working interest in oil and gas properties are as follows:

	Amount (in thousands)
Beginning balance at December 31, 2006	\$ 11,966
Obligations assumed with development activities and acquisitions	5,096
Accretion expense	469
Obligations discharged with disposed properties and asset retirements	(22)
Ending balance at June 30, 2007	\$ 17,509

Approximately \$50,000 of the \$17.5 million asset retirement obligation is classified as short term and included in other accrued expenses as of December 31, 2006, and June 30, 2007.

11. LONG-TERM DEBT

The Company has a credit facility with JPMorgan Chase Bank, N.A. ("JPMorgan") and BNP Paribas of \$200 million subject to and collateralized by required levels of oil and natural gas reserves. Effective May 25, 2007, the Company's current borrowing base, based upon current oil and natural gas reserves, was increased from \$100 million to \$135 million, which was fully activated at that time. The Company is required to pay a commitment fee of 0.25% to 0.375% per annum on the unused portion of the activated credit facility. Interest accrues at an alternative base rate ("ABR") or adjusted LIBOR at the discretion of the Company. The ABR is the greater of JPMorgan's prime rate, an adjusted secondary market rate for a three-month certificate of deposit plus 1% or the federal funds effective rate plus 0.5%. ABR borrowings are assessed an additional margin spread up to 0.375% and adjusted LIBOR borrowings are assessed an additional margin spread of 1.125% to 1.875%. The margin spread charges are based upon the

outstanding balance under the credit facility. No principal payments are required until the credit agreement expires on November 4, 2010.

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On December 19, 2006, the Company executed, pursuant to its credit facility, an overline note in the amount of \$20 million to be repaid on January 31, 2007. Interest on the overline note accrued at a per annum rate equal to the alternate base rate plus 0.80% until December 22, 2006, at which time the rate converted to a Eurodollar borrowing for a one month period and at a per annum rate equal to an adjusted LIBOR rate plus 2.30%. The overline note was paid in full in accordance with its terms in January 2007.

As of June 30, 2007, the outstanding balance under the credit facility was \$124 million compared to \$117 million, excluding the overline note discussed above, as of December 31, 2006. Any amounts outstanding under the credit facility are collateralized by substantially all of the Company's properties. At June 30, 2007, the outstanding balance was subject to an ABR of 8.625%. The credit agreement requires, among other things, the existence of satisfactory levels of oil and natural gas reserves and the maintenance of certain working capital and tangible net worth ratios. At June 30, 2007, the Company was not in compliance with its current ratio covenant. Effective July 5, 2007, the Company increased its borrowing base by \$15 million to \$150 million, and effective August 9, 2007, the Company amended its credit facility adding a new bank, Wachovia Bank, N.A. and increasing its aggregate commitments from \$150 million to \$200 million. The amendment also waives the working capital covenant until the earlier of (i) a debt or equity transaction resulting in net proceeds to the Company of at least \$200 million or (ii) July 1, 2008. Under the amended agreement the ABR rate was increased by 0.375% as long as the waiver of the Company's non-compliance with the working capital covenant is in effect. The Company believes that after this amendment the Company will be able to sustain compliance with all covenants.

12. SUPPLEMENTAL CASH FLOW DISCLOSURE

	Six Months Ended June 30,	
	2007	2006
	<i>(in thousands)</i>	
Cash paid for:		
Interest	\$ 3,915	\$ 608
Income taxes	42,447	18,335
Non-cash investing activities:		
Change in deferred tax liability resulting from reallocation of acquisition purchase price	4,188	-
Changes in accounts payable - affiliates related to acquisition of partnerships	668	-
Changes in accounts payable related to purchases of property and equipment	27,335	2,456

13. COMMITMENTS AND CONTINGENCIES

The Company would be exposed to oil and natural gas price fluctuations on underlying purchase and sale contracts should the counterparties to the Company's derivative instruments or the counterparties to the Company's natural gas marketing contracts not perform. Nonperformance is not anticipated. There were no counterparty default losses in 2006 or through the second quarter of 2007.

In connection with the Company's sale of undeveloped leaseholds in July 2006, the Company, pursuant to the purchase and sale agreement, was obligated to either drill 16 wells on specifically identified acreage over the next three years or pay liquidated damages of \$1.6 million per undrilled well for a total contingent obligation of \$25.6 million, which was reflected as a deferred gain on sale of leaseholds in the accompanying condensed consolidated balance sheet at December 31, 2006. On May 31, 2007, the Company entered into a letter agreement amending the original purchase

and sale agreement. The letter agreement relieved the Company of its obligation, in its entirety, to either drill 16 wells or pay liquidated damages, resulting in the recognition of the remaining \$25.6 million deferred gain on sale of leaseholds in the quarter ended June 30, 2007.

Pursuant to the above letter agreement, the Company is obligated to drill six wells on specifically identified acreage. These wells will be drilled on the unaffiliated party's leasehold for its benefit and at its cost. In addition, the unaffiliated party will return 160 acres of leasehold property acquired from the Company pursuant to the purchase and sale agreement. The Company is currently drilling the first of the six wells.

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The Company was party to an exploration agreement with an unaffiliated party. The agreement required the Company to drill a minimum of 25 exploratory wells through June 30, 2007. For each well the Company failed to drill prior to June 30, 2007, the Company was required to pay liquidated damages equal to \$125,000 per undrilled well. After drilling three exploratory wells, the Company determined, based on drilling results, not to drill the remaining 22 exploratory wells. During the quarter ended June 30, 2007, the Company recorded charges to exploration expense for the liquidated damages of \$2.8 million related to the 22 undrilled wells and \$1.1 million related to the write-off of the carrying value of the acreage resulting from the abandonment of the project. With regard to the liquidated damages and while the Company acknowledges its liability, the Company is currently negotiating an alternative settlement of this liability. However, there can be no assurance that an alternative settlement will be reached.

The Company is currently offering its 2007 drilling partnership, Rockies Region 2007 Limited Partnership, and, as of August 7, 2007, has received subscriptions of \$53 million, with a maximum amount of subscriptions of \$110 million to be funded. The Company expects the partnership to be funded and drilling for the new program is scheduled to commence in the third quarter of 2007, with drilling and completion operations continuing through the first and second quarters of 2008. No assurance can be made that the Company will continue to receive this level of funding from this or future programs. The Company invests, as its equity contribution to each drilling partnership, a sum equal to approximately 43% of the aggregate subscriptions received in the current drilling partnership being offered. As a result, the Company is subject to substantial cash commitments at the closing of each drilling partnership. The Company expects to fund its equity contribution in the third quarter of 2007.

Substantially all of the Company's drilling programs contain a repurchase provision where investing partners may request that the Company purchase their partnership units at any time beginning with the third anniversary of the first cash distribution. The provision provides that the Company is obligated to purchase an aggregate of 10% of the initial subscriptions per calendar year (at a minimum price of four times the most recent 12 months' cash distributions), if repurchase is requested by investors, and subject to the Company's financial ability to do so. The maximum annual potential repurchase obligation as of June 30, 2007, was approximately \$6.1 million. The Company has adequate liquidity to meet this potential obligation. During 2006 and the first six months of 2007, the Company paid \$0.8 million and \$0.7 million, respectively, under this provision for the repurchase of partnership units.

As managing general partner of 32 partnerships, the Company has liability for any potential casualty losses in excess of the partnership assets and insurance. The Company's management believes the casualty insurance coverage carried by the Company and its subcontractors is adequate to meet this potential liability.

In order to secure the services for two drilling rigs, the Company made commitments to the drilling contractor, which call for a minimum commitment of \$9,000 daily for a specified amount of time if the Company does not use the drilling rigs, an event that is not anticipated to occur, and a maximum commitment of \$38,800 daily for a specified amount of time for daily use of the drilling rigs. Commitments for these two separate contracts expire in July 2009 and May 2010. As of June 30, 2007, the Company has an outstanding minimum commitment for \$8.1 million and an outstanding maximum commitment for \$35.3 million.

14. LEGAL PROCEEDINGS

From time to time, the Company is a party to various legal proceedings in the ordinary course of business. While it is not possible to determine with any degree of certainty the ultimate outcome of the following legal proceeding, the Company believes that it has meritorious defenses with respect to the claims asserted against it and intends to vigorously defend its position. An adverse outcome in the case below or any similar case could have a material adverse effect, individually and collectively, on the Company's financial position, liquidity and results of operations.

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Royalty Payments. On May 29, 2007, Glen Droegemueller, individually and as representative plaintiff on behalf of all others similarly situated, filed a class action complaint against the Company in the District Court, Weld County, Colorado alleging that the Company underpaid royalties on natural gas produced from wells operated by the Company in the State of Colorado (the "Droegemueller Action"). The plaintiff seeks declaratory relief and to recover an unspecified amount of compensation for underpayment of royalties made by the Company to the plaintiff pursuant to leases. The Company moved the case to Federal Court on June 28, 2007, and on July 10, 2007, the Company filed its answer and affirmative defenses. Given the preliminary stage of this proceeding and the inherent uncertainty in litigation, the Company is unable to predict the ultimate outcome of this suit at this time.

Litigation similar to the Droegemueller Action has recently been commenced against several other companies in other jurisdictions where the Company conducts business. While the Company's business model differs from that of the parties involved in such other litigation, and although the Company has not been named as a party in such other litigation, there can be no assurance that the Company will not be named as a party to such other litigation in the future.

Other. The Company is involved in various other legal proceedings that it considers normal to its business. The Company believes that the ultimate outcome of such other proceedings will not have a material adverse effect on its financial position, liquidity or results of operations.

15. BUSINESS SEGMENTS

The Company's operating activities are divided into four major segments: oil and gas sales, natural gas marketing, drilling and development, and well operations and pipeline income. The Company owns an interest in approximately 3,400 wells from which it sells its oil and natural gas production from its working interests in the wells. Included in the oil and gas sales segment are the operating results of the acquisitions described in Note 3. A wholly-owned subsidiary, Riley Natural Gas ("RNG"), engages in the marketing of natural gas to commercial and industrial end-users. The Company drills natural gas wells for Company-sponsored drilling partnerships and retains an interest in each well. The Company charges Company-sponsored partnerships and other third parties competitive industry rates for well operations and natural gas gathering. All material inter-company accounts and transactions between segments have been eliminated.

Segment information for the three and six months ended June 30, 2007 and 2006, is presented below.

	Three Months Ended June 30, 2007		Six Months Ended June 30, 2007					
		2006		2006				
		<i>*Revised</i>		<i>*Revised</i>				
	<i>(in thousands)</i>							
Revenues:								
Oil and gas sales ⁽¹⁾	\$	42,988	\$	29,362	\$	71,359	\$	62,619
Natural gas marketing		29,924		29,129		51,911		71,071
Drilling and development		1,739		3,745		5,769		9,023
Well operations and pipeline income		1,292		2,486		4,590		4,776
Unallocated amounts		2		21		228		24
Total	\$	75,945	\$	64,743	\$	133,857	\$	147,513
Segment income (loss) before income taxes:								
Oil and gas sales ⁽²⁾	\$	8,521	\$	14,997	\$	14,360	\$	35,474
Natural gas marketing		1,345		800		2,024		1,124

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Drilling and development	1,493	467	4,959	1,534
Well operations and pipeline income	179	612	1,414	1,031
Unallocated amounts ⁽³⁾	17,262	(5,404)	9,980	(9,336)
Total	\$ 28,800	\$ 11,472	\$ 32,737	\$ 29,827

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	June 30, 2007	December 31, 2006
	<i>(in thousands)</i>	
Segment assets:		
Oil and gas sales	\$ 647,816	\$ 394,952
Natural gas marketing	33,296	39,899
Drilling and development ⁽⁴⁾	53,188	87,746
Well operations and pipeline income	38,712	28,895
Unallocated amounts ⁽⁵⁾	63,671	332,795
Total	\$ 836,683	\$ 884,287

* See Note 1.

(1) *Includes oil and gas price risk management, net.*

(2) *Includes \$9.5 million and \$3.1 million in exploration expense and \$28.9 million and \$13.2 million of DD&A for the six months ended June 30, 2007 and 2006, respectively.*

(3) *Includes general and administrative expense, interest income, interest expense, and DD&A expense of \$0.4 million and \$0.1 million for the six months ended June 30, 2007 and 2006, respectively. The three and six months ended June 30, 2007, includes \$25.6 million related to the gain on sale of leasehold.*

(4) *The December 31, 2006, amount includes cash of \$50.7 million for partnership drilling activities, which was substantially utilized by June 30, 2007.*

(5) *Includes primarily unallocated cash. The December 31, 2006, amount includes designated cash of \$191.5 million, which was utilized in LKE property transactions during the first quarter of 2007 and included in the oil and gas sales segment as of June 30, 2007.*

16. DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilizes commodity based derivative instruments to manage a portion of its exposure to price risk from its oil and natural gas sales and marketing activities. Company policy prohibits the use of oil and natural gas future and option contracts for speculative purposes. These instruments consist of New York Mercantile Exchange ("NYMEX") traded natural gas futures contracts and option contracts for Appalachian and Michigan production, Panhandle-based contracts and NYMEX-traded contracts for Northeast Colorado ("NECO") production and Colorado Interstate Gas Index ("CIG") based contracts for other Colorado production. The Company purchases puts and participating collars for its own and affiliate partnerships production to protect against possible price instability in future periods while retaining much of the benefits of price increases. RNG enters into fixed-price physical purchase and sale agreements that are derivative contracts. In order to offset these fixed-price physical derivatives, the Company enters into financial derivative instruments that have the effect of locking in the prices the Company will receive or pay for the same volumes and period, offsetting the physical derivative. As a result, while these derivatives are structured to reduce the Company's exposure to changes in price associated with the derivative commodity, they also limit the benefit the Company might otherwise have received from price changes in the physical market.

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The following tables summarize the open derivative option and purchase and sales contracts for PDC and RNG as of June 30, 2007.

Petroleum Development Corporation
Open Derivative Positions
(dollars in thousands, except average price data)

Commodity	Type	Quantity Gas-MMbtu Oil-Barrels	Weighted Average Price	Total Contract Amount	Fair Value
Total Positions as of June 30, 2007					
Natural Gas	Cash Settled Option Sales	16,780,000	\$ 10.69	\$ 179,387	\$ (4,874)
Natural Gas	Cash Settled Option Purchases	26,920,000	5.56	149,598	14,760
Oil	Cash Settled Option Purchases	120,000	50.00	6,000	(3)

Positions maturing in 12 months
following June 30, 2007

Natural Gas	Cash Settled Option Sales	9,900,000	\$ 10.70	\$ 105,927	\$ (2,608)
Natural Gas	Cash Settled Option Purchases	20,040,000	5.48	109,878	10,940
Oil	Cash Settled Option Purchases	120,000	50.00	6,000	(3)

The maximum term for the derivative contracts listed above is 16 months.

Riley Natural Gas
Open Derivative Positions
(dollars in thousands, except average price data)

Commodity	Type	Quantity Gas-MMbtu	Weighted Average Price	Total Contract Amount	Fair Value
Total Positions as of June 30, 2007					
Natural Gas	Cash Settled Futures/Swaps Purchases	252,200	\$ 7.30	\$ 1,840	\$ (107)
Natural Gas	Cash Settled Futures/Swaps	2,278,600	8.52	19,412	1,702

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	Sales				
	Cash Settled				
Natural Gas	Option Purchases	120,000	5.50	660	10
	Cash Settled				
Natural Gas	Option Sales	60,000	10.10	606	(13)
Natural Gas	Physical Purchases	2,278,600	8.51	19,396	(878)
Natural Gas	Physical Sales	132,220	9.43	1,247	148

Positions maturing in 12 months following
June 30, 2007

	Cash Settled				
	Futures/Swaps				
Natural Gas	Purchases	252,200	\$ 7.30	\$ 1,840	\$ (107)
	Cash Settled				
	Futures/Swaps				
Natural Gas	Sales	1,933,600	8.50	16,439	1,687
	Cash Settled				
Natural Gas	Option Purchases	120,000	5.50	660	10
	Cash Settled				
Natural Gas	Option Sales	60,000	10.10	606	(13)
Natural Gas	Physical Purchases	1,933,600	8.49	16,407	(960)
Natural Gas	Physical Sales	132,220	9.43	1,247	147

The maximum term for the derivative contracts listed above is 19 months.

In addition to including the gross assets and liabilities related to the Company's share of oil and natural gas production, the above tables and the accompanying condensed consolidated balance sheets include the gross assets and liabilities related to derivative contracts entered into by the Company on behalf of the affiliate partnerships as the managing general partner. The accompanying condensed consolidated balance sheets include the fair value of derivatives and a corresponding net payable to the partnerships of \$4.6 million as of June 30, 2007, and \$7.5 million as of December 31, 2006.

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The Company is required to maintain margin deposits with brokers for outstanding futures contracts. As of June 30, 2007, and December 31, 2006, restricted cash - current in the amount of \$0.8 million and \$0.5 million was on deposit.

By using derivative financial instruments to manage exposures to changes in interest rates and commodity prices, the Company exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Company, which creates repayment risk. The Company minimizes the credit or repayment risk in derivative instruments by entering into transactions with high-quality counterparties. There were no counterparty defaults in 2006 or during the six months ended June 30, 2007.

The following table identifies the fair value of commodity based derivatives as classified in the condensed consolidated balance sheets.

	June 30, 2007	December 31, 2006
	<i>(in thousands)</i>	
Classification in the Condensed Consolidated Balance Sheets:		
Fair value of derivatives - current asset	\$ 12,785	\$ 15,012
Other assets - long-term asset	3,925	1,146
	16,710	16,158
Fair value of derivatives - current liability	3,692	2,545
Other liabilities - long-term liability	2,273	-
	5,965	2,545
Net fair value of commodity based derivatives	\$ 10,745	\$ 13,613

The following tables identify the changes in the fair value of commodity based derivatives as reflected in the condensed consolidated statements of income.

	Three Months Ended June 30,			
	2007		2006	
Statement of income line item	Realized	Unrealized	Realized	Unrealized
	<i>(in thousands, gains/(losses))</i>			
Oil and gas price risk management, net	\$ 27	\$ 3,715	\$ 48	\$ 1,322 ⁽¹⁾
Sales from natural gas marketing activities	231	2,030		