PETROLEUM DEVELOPMENT CORP
Form 10-Q
May 10, 2012
Table of Contents

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

FORM 10-Q

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

For the quarterly period ended March 31, 2012

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)
(Doing Business as PDC Energy)

Nevada	95-2636730
(State of Incorporation)	(I.R.S. Employer Identification No.)

1775 Sherman Street, Suite 3000
Denver, Colorado 80203
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (303) 860-5800

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 T No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 T 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer £	Accelerated filer x
Non-accelerated filer £ (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes £ No T

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 23,665,459 shares of the Company's Common Stock ($0.01 par value) were outstanding as of April 20, 2012.

Table of Contents

PETROLEUM DEVELOPMENT CORPORATION
(dba PDC Energy)

TABLE OF CONTENTS

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 ("Securities Act") and Section 21E of the Securities Exchange Act of 1934 ("Exchange Act") regarding our business, financial condition, results of operations and prospects. All statements other than statements of historical facts included in and incorporated by reference into this report are "forward-looking statements" within the meaning of the safe harbor provisions of the United States ("U.S.") Private Securities Litigation Reform Act of 1995. Words such as expects, anticipates, intends, plans, believes, seeks, estimates and similar expressions or variations of such words are intended to identify forward-looking statements herein. These statements include: estimated natural gas, natural gas liquids ("NGLs") and crude oil production; future production levels and expenses, anticipated capital expenditures, including our ability to fund our 2012 capital budget; increased focus on the Wattenberg Field and liquid-rich areas and pursuing strategic and complementary acquisitions in Niobrara and Utica; our compliance with our debt covenants and the indenture restrictions governing our senior notes and expected continued compliance; the adequacy of our casualty insurance coverage as managing general partner of numerous partnerships and as operator of our own wells; the impact of decreased commodity prices on future borrowing base redeterminations; the effectiveness of our derivative policies in achieving our risk management objectives; the sufficiency of our monitoring procedures for the credit worthiness of our financial institutions; our expected remaining liability for uncertain tax positions; our ability to secure a joint venture partner for our Utica Shale acreage; the impact of outstanding legal issues; our ability to meet our partnership repurchase obligations, if applicable; our ability to benefit from crude oil and natural gas price differentials; and our strategies, plans and objectives.

The above statements are not the exclusive means of identifying forward-looking statements herein. Although forward-looking statements contained in this report reflect our good faith judgment, such statements can only be based on facts and factors currently known to us. Consequently, forward-looking statements are inherently subject to risks and uncertainties, including known and unknown risks and uncertainties incidental to the exploration for, and the acquisition, development, production and marketing of natural gas, NGLs and crude oil, and actual outcomes may differ materially from the results and outcomes discussed in the forward-looking statements.

Important factors that could cause actual results to differ materially from the forward-looking statements include, but are not limited to:

- changes in production volumes and worldwide demand, including economic conditions that might impact demand;
- volatility of commodity prices for natural gas, NGLs and crude oil;
- the impact of governmental fiscal terms and/or regulations, including changes in environmental laws, the regulation and enforcement related to those laws and the costs to comply with those laws, as well as other regulations;
- decline in the values of our natural gas and crude oil properties resulting in impairments;
- changes in estimates of proved reserves;
- inaccuracy of reserve estimates and expected production rates;
- the potential for production decline rates from our wells to be greater than expected;
- the timing and extent of our success in discovering, acquiring, developing and producing reserves;
- our ability to acquire leases, drilling rigs, supplies and services at reasonable prices;
- the timing and receipt of necessary regulatory permits;
- risks incidental to the drilling and operation of natural gas and crude oil wells;
- our future cash flow, liquidity and financial position;
- competition in the oil and gas industry;
- the availability and cost of capital to us;
- reductions in the borrowing base under our credit facility;
- the availability of sufficient pipeline and other transportation facilities to carry our production and the impact of these facilities on price;
- our success in marketing natural gas, NGLs and crude oil;

- the effect of natural gas and crude oil derivatives activities;
- the impact of environmental events, governmental responses to the events and our ability to insure adequately against such events;
- the cost of pending or future litigation;
- the effect that acquisitions we may pursue have on our capital expenditures;
- our ability to retain or attract senior management and key technical employees; and
- the success of strategic plans, expectations and objectives for future operations of the Company.

Further, we urge you to carefully review and consider the cautionary statements and disclosures, specifically those under the heading "Risk Factors," made in this report, our annual report on Form 10-K for the year ended December 31, 2011, filed with the United States Securities and Exchange Commission ("SEC") on March 1, 2012 ("2011 Form 10-K"), and our other filings with the SEC for further information on risks and uncertainties that could affect the Company's business, financial condition and results of operations, which are incorporated by this reference as though fully set forth herein. We caution you not to place undue reliance on forward-looking statements, which speak only as of the date of this report. We undertake no obligation to update any forward-looking statements in order to reflect any event or circumstance occurring after the date of this report or currently unknown facts or conditions or the occurrence of unanticipated events. All forward-looking statements are qualified in their entirety by this cautionary statement.

Table of Contents

REFERENCES

Unless the context otherwise requires, references in this report to "PDC," "PDC Energy," "the Company," "we," "us," "our," "ours" or "ourselves" refer to the registrant, Petroleum Development Corporation, and all subsidiaries consolidated for the purposes of its financial statements, including our proportionate share of the financial position, results of operations, cash flows and operating activities of our affiliated partnerships and PDC Mountaineer, LLC ("PDCM"), a joint venture currently owned 50% each by PDC and Lime Rock Partners, LP formed for the purpose of exploring and developing the Marcellus Shale formation in the Appalachian Basin ("Marcellus JV"). Unless the context otherwise requires, references in this report to "Appalachian Basin" includes PDC's proportionate share of our affiliated partnerships' and the Marcellus JV's assets, results of operations, cash flows and operating activities.

See Note 1, Nature of Operations and Basis of Presentation, to our condensed consolidated financial statements included in this report for a description of our consolidated subsidiaries.

References to "the three months ended 2012" refer to the three months ended March 31, 2012, as applicable. References to "the three months ended 2011" refer to the three months ended March 31, 2011, as applicable.

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PETROLEUM DEVELOPMENT CORPORATION
(dba PDC Energy)
Condensed Consolidated Balance Sheets
(unaudited; in thousands, except share and per share data)

	March 31, 2012	December 31, 2011 (1)
Assets		
Current assets:		
Cash and cash equivalents	$1,655	$8,238
Restricted cash	2,315	11,070
Accounts receivable, net	64,019	59,923
Accounts receivable affiliates	9,534	8,518
Fair value of derivatives	74,778	60,809
Prepaid expenses and other current assets	7,672	24,492
Total current assets	159,973	173,050
Properties and equipment, net	1,329,460	1,301,716
Assets held for sale	—	148,249
Fair value of derivatives	36,751	41,175
Accounts receivable affiliates	2,147	2,836
Other assets	37,238	30,979
Total Assets	$1,565,569	$1,698,005
Liabilities and Equity		
Liabilities		
Current liabilities:		
Accounts payable	$56,152	$76,027
Accounts payable affiliates	11,682	10,176
Production tax liability	19,170	18,949
Fair value of derivatives	30,513	27,974
Funds held for distribution	30,093	28,594
Accrued interest payable	5,069	11,243
Other accrued expenses	12,583	22,083
Total current liabilities	165,262	195,046
Long-term debt	414,809	532,157
Deferred income taxes	198,082	207,573
Asset retirement obligations	45,172	46,316
Fair value of derivatives	25,815	21,106
Accounts payable affiliates	5,207	6,134
Other liabilities	29,990	25,561
Total liabilities	884,337	1,033,893
Commitments and contingent liabilities		
Shareholders' equity:		
Preferred shares, par value $0.01 per share; authorized 50,000,000	—	—

shares; issued: none		
Common shares, par value $0.01 per share; authorized 100,000,000	237	236
shares; issued: 23,659,339 in 2012 and 23,634,958 in 2011		
Additional paid-in capital	219,139	217,707
Retained earnings	462,115	446,280
Treasury shares, at cost: 6,944 in 2012 and 2,938 in 2011	(259)	(111)
Total shareholders' equity	681,232	664,112
Total Liabilities and Equity	$1,565,569	$1,698,005

____
(1) Derived from audited 2011 balance sheet.

See accompanying Notes to Condensed Consolidated Financial Statements
5

Table of Contents

PETROLEUM DEVELOPMENT CORPORATION
(dba PDC Energy)
Condensed Consolidated Statements of Operations
(unaudited; in thousands, except per share data)

	Three Months Ended March 31,	
	2012	2011
Revenues:		
Natural gas, NGL and crude oil sales	$75,310	$58,810
Sales from natural gas marketing	11,834	15,202
Commodity price risk management gain (loss), net	11,501	(23,882)
Well operations, pipeline income and other	1,701	1,843
Total revenues	100,346	51,973
Costs, expenses and other:		
Production costs	19,189	18,472
Cost of natural gas marketing	11,492	14,993
Exploration expense	2,063	1,669
Impairment of natural gas and crude oil properties	653	453
General and administrative expense	14,708	13,873
Depreciation, depletion and amortization	39,814	30,985
Gain on sale of properties and equipment	(154)	—
Total costs, expenses and other	87,765	80,445
Income (loss) from operations	12,581	(28,472)
Interest income	2	9
Interest expense	(10,444)	(9,062)
Income (loss) from continuing operations before income taxes	2,139	(37,525)
Provision (benefit) for income taxes	759	(14,278)
Income (loss) from continuing operations	1,380	(23,247)
Income from discontinued operations, net of tax	14,455	3,323
Net income (loss)	$15,835	$(19,924)
Earnings (loss) per share:		
Basic		
Income (loss) from continuing operations	$0.06	$(0.99)
Income from discontinued operations	0.61	0.14
Net income (loss)	$0.67	$(0.85)
Diluted		
Income (loss) from continuing operations	$0.06	$(0.99)
Income from discontinued operations	0.60	0.14
Net income (loss)	$0.66	$(0.85)
Weighted average common shares outstanding		
Basic	23,609	23,428
Diluted	23,889	23,428

See accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents

PETROLEUM DEVELOPMENT CORPORATION
(dba PDC Energy)
Condensed Consolidated Statements of Cash Flows
(unaudited, in thousands)

	Three Months Ended March 31, 2012	2011
Cash flows from operating activities:		
Net income (loss)	$15,835	$(19,924)
Adjustments to net income to reconcile to net cash provided by operating activities:		
Unrealized (gain) loss on derivatives, net	(1,533)	27,745
Depreciation, depletion and amortization	39,814	32,357
Impairment of natural gas and crude oil properties	653	453
Exploratory dry hole costs	—	35
Loss (gain) from sale of properties and equipment	(20,489)	(3,928)
Deferred income taxes	10,914	(14,024)
Stock-based compensation	1,946	1,545
Amortization of debt discount and issuance costs	1,641	1,704
Other	699	136
Changes in assets and liabilities	(5,181)	(10,623)
Net cash provided by operating activities	44,299	15,476
Cash flows from investing activities:		
Capital expenditures	(107,029)	(71,079)
Acquisition of natural gas and crude oil properties	(10,000)	—
Proceeds from sale of properties and equipment	184,646	9,952
Other	—	(101)
Net cash provided by (used in) investing activities	67,617	(61,228)
Cash flows from financing activities:		
Proceeds from credit facility	144,750	—
Payment of credit facility	(263,000)	—
Contribution from noncontrolling interest	—	6,407
Other	(249)	(328)
Net cash provided by (used in) financing activities	(118,499)	6,079
Net decrease in cash and cash equivalents	(6,583)	(39,673)
Cash and cash equivalents, beginning of period	8,238	54,372
Cash and cash equivalents, end of period	$1,655	$14,699
Supplemental cash flow information:		
Cash payments (receipts) for:		
Interest, net of capitalized interest	$14,975	$12,314
Income taxes, net of refunds	(1,100)	85
Non-cash investing activities:		
Change in accounts payable related to purchases of properties and equipment	(21,044)	5,832
Change in asset retirement obligation, with a corresponding increase to natural gas and crude oil properties, net of disposals	(1,962)	229

See accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents
PETROLEUM DEVELOPMENT CORPORATION
(dba PDC Energy)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2012
(unaudited)

NOTE 1 - NATURE OF OPERATIONS AND BASIS OF PRESENTATION

PDC Energy is a domestic independent natural gas and crude oil company engaged in the exploration for and the acquisition, development, production and marketing of natural gas, NGLs and crude oil. As of March 31, 2012, we owned an interest in approximately 6,500 gross wells located primarily in the Appalachian Basin, the Wattenberg Field, northeast Colorado and the Piceance Basin. We are engaged in two business segments: (1) Oil and Gas Exploration and Production and (2) Gas Marketing.

The accompanying unaudited condensed consolidated financial statements include the accounts of PDC, our wholly-owned subsidiaries, and our proportionate share of PDC Mountaineer, LLC ("PDCM") and 21 of our affiliated partnerships. Pursuant to the proportionate consolidation method, our accompanying consolidated financial statements include our pro rata share of assets, liabilities, revenues and expenses of the entities which we proportionately consolidate. All material intercompany accounts and transactions have been eliminated in consolidation.

In our opinion, the accompanying financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of our financial statements for interim periods in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, pursuant to such rules and regulations, certain notes and other financial information included in audited financial statements have been condensed or omitted. The information presented in this quarterly report on Form 10-Q should be read in conjunction with our audited consolidated financial statements and notes thereto included in our 2011 Form 10-K. The results of operations and the cash flows for the three months ended 2012 are not necessarily indicative of the results to be expected for the full year or any other future period.

Certain reclassifications have been made to prior period financial statements to conform to the current year presentation. We reclassified the derivatives fair value hierarchy level of our PEPL and CIG-based natural gas fixed-price swaps, crude oil fixed-price swaps, basis swaps and natural gas physical purchases from Level 3 to Level 2. This reclassification had no impact on previously reported cash flows, net income, earnings per share or shareholders' equity.

NOTE 2 - RECENT ACCOUNTING STANDARDS

Recently Adopted Accounting Standards

Fair Value Measurement. On May 12, 2011, the FASB issued changes related to fair value measurement. The changes represent the converged guidance of the FASB and the International Accounting Standards Board ("IASB") on fair value measurement. Many of the changes eliminate unnecessary wording differences between International Financial Reporting Standards ("IFRS") and U.S. GAAP. The changes expand existing disclosure requirements for fair value measurements categorized in Level 3 by requiring (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, (2) a description of the valuation processes in place and (3) a narrative description of the sensitivity of the fair value to changes in unobservable inputs and the interrelationships between those inputs. In addition, the changes require the categorization by level in the fair value hierarchy of items that are not measured at fair value in the statement of financial position whose fair value must be disclosed. These changes are to be applied prospectively and are effective for public entities during interim and annual periods beginning after December 15, 2011. The adoption of these changes did not have a significant impact on our financial statements.

NOTE 3 - FAIR VALUE MEASUREMENTS AND DISCLOSURES

Derivative Financial Instruments

Determination of fair value. Our fair value measurements are estimated pursuant to a fair value hierarchy that requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, giving the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The lowest level input that is significant to a fair value measurement in its entirety determines the applicable level in the fair value hierarchy. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability, and may affect the valuation of the assets and liabilities and their placement within the fair value hierarchy levels. The three levels of inputs that may be used to measure fair value are defined as:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for the asset or liability, including (i) quoted prices for similar assets or liabilities in active markets, (ii) quoted prices for identical or similar assets or liabilities in inactive markets, (iii) inputs other than quoted prices that are observable for the asset or liability and (iv) inputs that are derived from observable market data by correlation or other means. Includes our fixed-price swaps, basis swaps and physical purchases.

Table of Contents

Level 3 – Unobservable inputs for the asset or liability, including situations where there is little, if any, market activity for the asset or liability. Includes our natural gas and crude oil collars, crude oil puts and physical sales.

Derivative Financial Instruments. We measure the fair value of our derivative instruments based on a pricing model that utilizes market-based inputs, including but not limited to the contractual price of the underlying position, current market prices, natural gas and crude oil forward curves, discount rates such as the LIBOR curve for a similar duration of each outstanding position, volatility factors and nonperformance risk. Nonperformance risk considers the effect of our credit standing on the fair value of derivative liabilities and the effect of our counterparties' credit standings on the fair value of derivative assets. Both inputs to the model are based on published credit default swap rates and the duration of each outstanding derivative position.

We validate our fair value measurement through (1) the review of counterparty statements and other supporting documentation, (2) the determination that the source of the inputs is valid, (3) the corroboration of the original source of inputs through access to multiple quotes, if available, or other information and (4) monitoring changes in valuation methods and assumptions. While we use common industry practices to develop our valuation techniques, changes in our pricing methodologies or the underlying assumptions could result in significantly different fair values. While we believe our valuation method is appropriate and consistent with those used by other market participants, the use of a different methodology, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value.

We have evaluated the credit risk of the counterparties holding our derivative assets, which are primarily financial institutions who are also major lenders in our corporate credit facility agreement, giving consideration to amounts outstanding for each counterparty and the duration of each outstanding derivative position. Based on our evaluation, we have determined that the impact of the nonperformance of our counterparties on the fair value of our derivative instruments is insignificant.

The following table presents, for each hierarchy level, our assets and liabilities, including both current and non-current portions, measured at fair value on a recurring basis.

	March 31, 2012			December 31, 2011		
	Significant other observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Significant other observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(in thousands)					
Assets:						
Commodity based derivatives contracts	$ 84,707	$ 26,774	$ 111,481	$ 76,104	$ 25,837	$ 101,941
Basis protection derivative contracts	27	21	48	5	38	43
Total assets	84,734	26,795	111,529	76,109	25,875	101,984
Liabilities:						
Commodity based derivatives contracts	18,710	7,151	25,861	9,888	3,768	13,656
	30,467	—	30,467	35,424	—	35,424

Basis protection derivative contracts						
Total liabilities	49,177	7,151	56,328	45,312	3,768	49,080
Net asset	$35,557	$ 19,644	$55,201	$30,797	$ 22,107	$52,904

9

The following table presents a reconciliation of our Level 3 fair value measurements.

	Three Months Ended March 31,	
	2012	2011 (1)
	(in thousands)	
Fair value, net asset, beginning of period	$22,107	$10,762
Changes in fair value included in statement of operations line item:		
Commodity price risk management gain (loss), net	1,416	(9,885)
Sales from natural gas marketing	43	14
Changes in fair value included in balance sheet line item (2):		
Accounts receivable affiliates	—	49
Accounts payable affiliates	(52)	(654)
Settlements included in statement of operations line items:		
Commodity price risk management gain (loss), net	(3,797)	(2,910)
Sales from natural gas marketing	(73)	(75)
Fair value, net asset, end of period	$19,644	$(2,699)
Changes in unrealized gains (losses) relating to assets (liabilities) still held as of period end, included in statement of operations line item:		
Commodity price risk management gain, net	$1,282	$(7,538)
Sales from natural gas marketing	3	(7)
	$1,285	$(7,545)

____

(1) We reclassified our PEPL and CIG-based natural gas fixed-price swaps, crude oil fixed-price swaps, basis swaps and natural gas physical purchases from Level 3 to Level 2 (decreasing the previously reported net liability at the beginning of 2011 by $54.1 million). The amounts presented reflect these reclassifications and conform to current period presentation.

(2) Represents the change in fair value related to derivative instruments entered into by us and designated to our affiliated partnerships.

The significant unobservable input used in the fair value measurement of our derivative contracts is the implied volatility curve, and is provided by a third party vendor. A significant increase or decrease in the implied volatility, in isolation, would have a directionally similar effect resulting in a significantly higher or lower fair value measurement of our Level 3 derivative contracts.

See Note 4 for additional disclosure related to our derivative financial instruments.

Non-Derivative Financial Assets and Liabilities

The carrying values of the financial instruments comprising current assets and current liabilities approximate fair value due to the short-term maturities of these instruments.

The liability associated with our non-qualified deferred compensation plan for non-employee directors may be settled in cash or shares of our common stock. The carrying value of this obligation is based on the quoted market price of our common stock, which is a Level 1 input. As of March 31, 2012, and December 31, 2011, the liability related to this plan was immaterial.

The portion of our long-term debt related to our corporate credit facility, as well as our proportionate share of PDCM's credit facility, approximates fair value due to the variable nature of its related interest rate. We have not elected to account for the portion of our long-term debt related to our senior notes under the fair value option; however, as of March 31, 2012, we estimate the fair value of the portion of our long-term debt related to the 3.25% convertible senior notes due 2016 to be $127.9 million or 111.2% of par value and the portion related to our 12% senior notes due 2018 to be $220.3 million or 108.5% of par value. We determined these valuations based upon measurements of trading activity and broker and/or dealer quotes, respectively, which are published market prices and therefore Level 1 inputs.

NOTE 4 - DERIVATIVE FINANCIAL INSTRUMENTS

As of March 31, 2012, we had derivative instruments in place for a portion of our anticipated production through 2015 for a total of 72,997 BBtu of natural gas and 3,134 MBbls of crude oil.

The following table presents the location and fair value amounts of our derivative instruments on the balance sheets. These derivative instruments were comprised of commodity floors, collars and swaps, basis protection swaps and physical sales and purchases.

Derivatives instruments not designated as hedges (1):		Balance sheet line item	Fair Value March 31, 2012	December 31, 2011
			(in thousands)	
Derivative assets:	Current			
	Commodity contracts			
	Related to natural gas and crude oil sales	Fair value of derivatives	$64,099	$51,220
	Related to affiliated partnerships (2)	Fair value of derivatives	8,959	8,018
	Related to natural gas marketing	Fair value of derivatives	1,691	1,528
	Basis protection contracts			
	Related to natural gas marketing	Fair value of derivatives	29	43
			74,778	60,809
	Non Current			
	Commodity contracts			
	Related to natural gas and crude oil sales	Fair value of derivatives	31,514	34,938
	Related to affiliated partnerships (2)	Fair value of derivatives	5,207	6,134
	Related to natural gas marketing	Fair value of derivatives	11	103
	Basis protection contracts			
	Related to natural gas marketing	Fair value of derivatives	19	—
			36,751	41,175
Total derivative assets			$111,529	$101,984
Derivative liabilities:	Current			
	Commodity contracts			
	Related to natural gas and crude oil sales	Fair value of derivatives	$10,492	$7,498
	Related to affiliated partnerships (3)	Fair value of derivatives	276	211
	Related to natural gas marketing	Fair value of derivatives	1,585	1,384
	Basis protection contracts			
	Related to natural gas and crude oil sales	Fair value of derivatives	15,166	15,762
	Related to affiliated partnerships (3)	Fair value of derivatives	2,992	3,116
	Related to natural gas marketing	Fair value of derivatives	2	3
			30,513	27,974
	Non Current			
	Commodity contracts			
	Related to natural gas and crude oil sales	Fair value of derivatives	13,378	4,357
	Related to affiliated partnerships (3)	Fair value of derivatives	123	113
	Related to natural gas marketing	Fair value of derivatives	7	93

	Basis protection contracts			
	Related to natural gas and crude oil sales	Fair value of derivatives	10,281	13,820
	Related to affiliated partnerships (3)	Fair value of derivatives	2,024	2,723
	Related to natural gas marketing	Fair value of derivatives	2	—
			25,815	21,106
Total derivative liabilities			$56,328	$49,080

---

(1) As of March 31, 2012, and December 31, 2011, none of our derivative instruments were designated as hedges.

(2) Represents derivative positions designated to our affiliated partnerships; accordingly, our accompanying balance sheets include a corresponding payable to our affiliated partnerships representing their proportionate share of the derivative assets.

(3) Represents derivative positions designated to our affiliated partnerships; accordingly, our accompanying balance sheets include a corresponding receivable from our affiliated partnerships representing their proportionate share of the derivative liabilities.

The following table presents the impact of our derivative instruments on our statements of operations.

	Three Months Ended March 31,					
	2012			2011		
Statement of operations line item	Reclassification of Realized Gains (Losses) Included in Prior Periods Unrealized	Realized and Unrealized Gains (Losses) For the Current Period	Total	Reclassification of Realized Gains (Losses) Included in Prior Periods Unrealized	Realized and Unrealized Gains (Losses) For the Current Period	Total
	(in thousands)					
Commodity price risk management gain, net						
Realized gains	$8,628	$1,299	$9,927	$3,322	$466	$3,788
Unrealized gains (losses)	(8,628)	10,202	1,574	(3,322)	(24,348)	(27,670)
Total commodity price risk management gain (loss), net	$—	$11,501	$11,501	$—	$(23,882)	$(23,882)
Sales from natural gas marketing						
Realized gains	$684	$109	$793	$1,007	$135	$1,142
Unrealized gains (losses)	(684)	759	75	(1,007)	(10)	(1,017)
Total sales from natural gas marketing	$—	$868	$868	$—	$125	$125
Cost of natural gas marketing						
Realized losses	$(591)	$(154)	$(745)	$(770)	$(190)	$(960)
Unrealized gains (losses)	591	(707)	(116)	770	172	942
Total cost of natural gas marketing	$—	$(861)	$(861)	$—	$(18)	$(18)

Derivative Counterparties. A significant portion of our liquidity is concentrated in derivative instruments that enable us to manage a portion of our exposure to price volatility from producing natural gas and crude oil. These arrangements expose us to credit risk of nonperformance by our counterparties. We primarily use financial institutions, who are also major lenders in our credit facility agreement, as counterparties to our derivative contracts. To date, we have had no counterparty default losses. We have evaluated the credit risk of our derivative assets from our counterparties using relevant credit market default rates, giving consideration to amounts outstanding for each counterparty and the duration of each outstanding derivative position. Based on our evaluation, the impact of the nonperformance of our counterparties on the fair value of our derivative instruments is not significant.

The following table presents the counterparties that expose us to credit risk as of March 31, 2012, with regard to our derivative assets.

Counterparty Name	Fair Value of Derivative Assets As of March 31, 2012
	(in thousands)

JPMorgan Chase Bank, N.A. (1)	$55,769
Crèdit Agricole CIB (1)	19,441
Wells Fargo Bank, N.A. (1)	20,099
Other lenders in our credit facility	16,135
Various (2)	85
Total	$111,529

____
(1)Major lender in our credit facility, see Note 7.
(2)Represents a total of 10 counterparties.

12

Table of Contents
PETROLEUM DEVELOPMENT CORPORATION
(dba PDC Energy)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 5 - PROPERTIES AND EQUIPMENT

The following table presents the components of properties and equipment, net of depreciation and assets held-for-sale.

	March 31, 2012	December 31, 2011
	(in thousands)	
Properties and equipment, net:		
Natural gas and crude oil properties		
Proved	$1,738,596	$1,694,694
Unproved	132,499	102,466
Total natural gas and crude oil properties	1,871,095	1,797,160
Pipelines and related facilities	42,062	40,721
Transportation and other equipment	32,878	32,475
Land and buildings	13,872	14,572
Construction in progress	61,584	69,633
Gross properties and equipment	2,021,491	1,954,561
Accumulated DD&A	(692,031)	(652,845)
Properties and equipment, net	$1,329,460	$1,301,716

NOTE 6 - INCOME TAXES

We evaluate our estimated annual effective income tax rate on a quarterly basis based on current and forecasted operating results and tax laws. The estimated annual effective tax rate is adjusted quarterly based upon actual results and updated operating forecasts; consequently, based upon the mix and timing of our actual earnings compared to annual projections, our effective tax rate may vary quarterly and may make quarterly comparisons not meaningful. A tax expense or benefit unrelated to the current year income or loss is recognized in its entirety as a discrete item of tax in the period identified. The quarterly income tax provision is generally comprised of tax on income or tax benefit on loss at the most recent estimated annual effective tax rate, adjusted for the effect of discrete items.

The effective tax rate for continuing operations for the three months ended 2012 was a 35.5% provision on income compared to a 38.1% benefit on loss for the three months ended 2011. The effective tax rate for the three months ended 2012 differs from the statutory rate primarily due to net permanent deductions, largely percentage depletion partially offset by nondeductible officer's compensation. The effective tax rate for the three months ended 2011 differs from the statutory rate primarily due to net permanent deductions, largely percentage depletion, increasing the tax benefit on pretax loss. There were no significant discrete items recorded during each of the three months ended 2012 or 2011.

As of March 31, 2012, we had a gross liability for unrecognized tax benefits of $0.2 million, unchanged from the amount recorded at December 31, 2011. If recognized, all of this liability would affect our effective tax rate. This liability is reflected in other accrued expenses on our accompanying balance sheet. We do not expect our remaining liability for uncertain tax positions to decrease in the next twelve months.

As of the date of this filing, we are current with our income tax filings in all applicable state jurisdictions and currently have no state income tax returns in the process of examination.

13

Table of Contents
PETROLEUM DEVELOPMENT CORPORATION
(dba PDC Energy)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 7 - LONG-TERM DEBT

Long-term debt consists of the following:

	March 31, 2012	December 31, 2011
	(in thousands)	
Senior notes		
3.25% Convertible senior notes due 2016:		
Principal amount	$115,000	$115,000
Unamortized discount	(16,250)	(17,079)
3.25% Convertible senior notes due 2016, net of discount	98,750	97,921
12% Senior notes due 2018:		
Principal amount	203,000	203,000
Unamortized discount	(1,691)	(1,764)
12% Senior notes due 2018, net of discount	201,309	201,236
Total senior notes	300,059	299,157
Credit facilities		
Corporate	82,000	209,000
PDCM	32,750	24,000
Total credit facilities	114,750	233,000
Total long-term debt	$414,809	$532,157

Senior Notes

3.25% Convertible Senior Notes Due 2016. In November 2010, we issued $115 million of 3.25% convertible senior notes due 2016 in a private placement. The maturity for the payment of principal is May 15, 2016. Interest at the rate of 3.25% per year is payable in cash semiannually in arrears on each May 15 and November 15. We allocated the gross proceeds of the convertible notes between the liability and equity components of the debt. The initial $94.3 million liability component was determined based on the fair value of similar debt instruments, excluding the conversion feature, with similar terms and priced on the same day we issued our convertible notes. The original issue discount and the deferred note issuance costs are being amortized to interest expense over the term of the debt using an effective interest rate of 7.4%. Upon conversion, the convertible notes may be settled, at our election, in shares of our common stock, cash or a combination of cash and shares of our common stock. We have initially elected a net-settlement method to satisfy our conversion obligation, which allows us to settle the $1,000 principal amount of the convertible notes in cash and to settle the excess conversion value in shares, as well as cash in lieu of fractional shares.

12% Senior Notes Due 2018. In 2008, we issued $203 million of 12% senior notes due 2018 in a private placement. The maturity for the payment of principal is February 15, 2018. Interest at the rate of 12% per year is payable in cash semiannually in arrears on each February 15 and August 15. The senior notes were issued at a discount, 98.572% of the principal amount. The indenture governing the notes contains customary representations and warranties as well as typical restrictive covenants. The original issue discount and the deferred note issuance costs are being amortized to interest expense over the term of the debt using the effective interest method.

We were in compliance with all covenants related to our senior notes as of March 31, 2012, and expect to remain in compliance throughout the next twelve-month period.

Bank Credit Facilities

Corporate Bank Credit Facility. We operate under a credit facility dated November 5, 2010, as amended last on October 12, 2011, with an aggregate revolving commitment or borrowing base of $400 million (as recently increased to $425 million). The maximum allowable facility amount is $600 million. The credit facility is with certain commercial lending institutions and is available for working capital requirements, capital expenditures, acquisitions, general corporate purposes, and to support letters of credit.

Our credit facility borrowing base is subject to size redetermination semiannually based on quantification of our reserves at December 31 and June 30 and is also subject to a redetermination upon the occurrence of certain events. The borrowing base of the credit facility will be the loan value assigned to the proved reserves attributable to our and our subsidiaries' natural gas and crude oil interests, excluding proved reserves attributable to PDCM and our 21 affiliated partnerships. The credit facility is secured by a pledge of the stock of certain of our subsidiaries, mortgages of certain producing natural gas and crude oil properties and substantially all of our and such subsidiaries' other assets. Neither PDCM nor the various limited partnerships that we have sponsored and continue to serve as the managing general partner are guarantors of the credit facility. See Note 15, Subsequent Events, for a discussion on our most recent borrowing base redetermination.

Our outstanding principal amount accrues interest at a varying interest rate that fluctuates with an alternate base rate (equal to the greater of JPMorgan Chase Bank, N.A.'s prime rate, the federal funds rate plus a premium and 1-month LIBOR plus a premium), or at our election, a rate equal to the rate for dollar deposits in the London interbank market for certain time periods. Additionally, commitment fees, interest margin and other bank fees, charged as a component of interest, vary with our utilization of the facility. No principal payments are required until the credit agreement expires on November 5, 2015, or in the event that the borrowing base falls below the outstanding balance. The credit facility contains covenants customary for agreements of this type.

We have outstanding an $18.7 million irrevocable standby letter of credit in favor of a third party transportation service provider to secure the construction of certain additions and/or replacements to its facilities to provide firm transportation of the natural gas produced by us and others for whom we market production in the Appalachian Basin. This letter of credit reduced the amount of available funds under our credit facility by an equal amount. We pay a fronting fee of 0.125% per annum and an additional quarterly maintenance fee equivalent to the spread over Eurodollar loans (2.0% per annum as of March 31, 2012) for the period the letter of credit remains outstanding. The letter of credit expires on July 20, 2012.

As of March 31, 2012, we had an outstanding balance of $82 million on our credit facility compared to $209 million as of December 31, 2011. We pay a fee of 0.5% per annum on the unutilized commitment on the available funds under our credit facility. As of March 31, 2012, the available funds under our credit facility, including a reduction for the $18.7 million irrevocable standby letter of credit in effect, was $299.3 million. The weighted average borrowing rate on our credit facility, exclusive of the letter of credit, was 3.9% per annum as of March 31, 2012 compared to 3.8% as of December 31, 2011.

PDCM Credit Facility. PDCM has a credit facility dated April 30, 2010, as amended last on November 18, 2011, with an aggregate revolving commitment or borrowing base of $80 million, of which our proportionate share would be $40 million. The credit facility is subject to and secured by PDCM's properties, including our proportionate share of such properties. The credit facility borrowing base is subject to size redetermination semiannually based upon a valuation of PDCM's reserves at December 31 and June 30; further, either PDCM or the lenders may request a redetermination upon the occurrence of certain events. Pursuant to the interests of the joint venture, the credit facility will be utilized by PDCM for the exploration and development of its Appalachian assets. As of March 31, 2012, our proportionate share of PDCM's outstanding credit facility draw was $32.8 million compared to $24 million as of December 31, 2011. PDCM pays a fee of 0.5% per annum on the unutilized commitment on the available funds under this credit facility.

As of March 31, 2012, both the Company and PDCM were in compliance with all bank credit facility covenants and expect to remain in compliance throughout the next twelve-month period.

NOTE 8 - ASSET RETIREMENT OBLIGATIONS

The following table presents the changes in carrying amounts of the asset retirement obligations associated with our working interest in natural gas and crude oil properties.

	Amount (in thousands)
Balance at December 31, 2011	$46,566
Obligations incurred with development activities	99
Accretion expense	818
Obligations discharged with disposal of properties and asset retirements	(2,061)
Balance at March 31, 2012	45,422
Less current portion	(250)
Long-term portion	$45,172

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Firm Transportation Agreements. We enter into contracts that provide firm transportation, sales and processing charges on pipeline systems through which we transport or sell our natural gas and the natural gas of working interest owners, PDCM, our affiliated partnerships and other third parties. These contracts require us to pay these transportation and processing charges whether the required volumes are delivered or not. Satisfaction of the volume requirements includes volumes produced by us, volumes purchased from third parties and volumes produced by PDCM and affiliated partnerships. We record in our financial statements only our share of costs based upon our working interest in the wells; however, with the exception of contracts entered into by PDCM, the costs of all volume shortfalls will be borne by PDC.

The following table presents gross volume information, including our proportionate share of PDCM, related to our long-term firm sales, processing and transportation agreements for pipeline capacity.

	For the Twelve Months Ending March 31,						
Area	2013	2014	2015	2016	2017 Through Expiration	Total	Expiration Date
Volume (MMcf)							
Piceance Basin	17,951	36,126	34,656	29,407	104,851	222,991	May 31, 2021
Appalachian Basin (1)	15,572	20,117	22,630	23,856	183,965	266,140	September 25, 2025
NECO	3,195	1,825	1,825	1,825	1,370	10,040	December 31, 2016
Total	36,718	58,068	59,111	55,088	290,186	499,171	