PETROLEUM DEVELOPMENT CORP
Form 10-K
March 20, 2008

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

FORM 10-K

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

For the fiscal year ended December 31, 2007

or

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

Commission File Number 000-07246

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

Nevada	95-2636730
(State of Incorporation)	(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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $.01 per share	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or non-accelerated file. See definition of "accelerated filer and larger accelerated filer" in Rule 12b-2 of the Exchange Act:

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨	Smaller reporting company ¨

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

The aggregate market value of our common stock held by non-affiliates on June 30, 2007, was $679,172,437 (based on the then closing price of $47.48).

As of March 14, 2008, there were 14,851,234 shares of our common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Form is incorporated by reference to our definitive proxy statement to be filed pursuant to Regulation 14A for our 2008 Annual Meeting of Shareholders.

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PART I

REFERENCES TO THE REGISTRANT

Unless the context otherwise requires, references to "PDC", "the Company", "we", "us", "our", "ours", or "ourselves" in this report refer to the registrant, Petroleum Development Corporation, together with our subsidiaries, proportionate share of our sponsored drilling partnerships and an entity in which we have a controlling interest.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 regarding our business, financial condition, results of operations and prospects. 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, which include statements of estimated oil and gas production and reserves, drilling plans, future cash flows, anticipated liquidity, anticipated capital expenditures and our management's strategies, plans and objectives. However, these 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 risks and uncertainties incidental to the exploration for, and the acquisition, development, production and marketing of, natural gas and 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, worldwide demand, and commodity prices for petroleum natural resources;
- the timing and extent of our success in discovering, acquiring, developing and producing natural gas and oil reserves;
- our ability to acquire leases, drilling rigs, supplies and services at reasonable prices;
- the availability of capital to us;
- risks incident to the drilling and operation of natural gas and oil wells;
- future production and development costs;
- the effect of existing and future laws, governmental regulations and the political and economic climate of the United States;
- the effect of natural gas and oil derivatives activities;
- conditions in the capital markets; and
- losses possible from pending or future litigation.

Further, we urge you to carefully review and consider the disclosures made in this report, including the risks and uncertainties that may affect our business as described herein under Item 1A, Risk Factors, and our other filings with the Securities and Exchange Commission, or SEC. 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 publicly 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.

ITEM 1. BUSINESS

General

We are an independent energy company engaged in the exploration, development, production and marketing of oil and natural gas. Since we began oil and gas operations in 1969, we have grown through drilling and development activities, acquisitions of producing natural gas and oil wells and the expansion of our natural gas marketing activities.

As of December 31, 2007, we owned interests in approximately 4,354 gross wells located in the Rocky Mountain Region and the Appalachian and Michigan Basins with 686 billion cubic feet equivalent, or Bcfe, of net proved reserves, of which 86.6% was natural gas and 13.4% was oil.

During 2007, our share of production was 28 Bcfe, averaging 76.6 MMcfe per day, a 65% increase over 46.4 MMcfe per day produced in 2006. We replaced our 2007 production with 391 Bcfe of new proved reserves, net of dispositions, for a reserve replacement rate of 1,397%. Reserve replacement through the drillbit was 256 Bcfe, or 914% of production, and reserve replacement through acquisitions was 135 Bcfe, or 483% of production. Proved reserves grew 112% during 2007, from 323 Bcfe to 686 Bcfe, of which 54% were proved developed reserves.

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We make available free of charge on our website at www.petd.com our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to these reports as soon as reasonably practicable after we electronically file these reports with, or furnish them to, the SEC. We will also make available to any shareholder, without charge, a copy of our Annual Report on Form 10-K, or any other filing, as filed with the SEC, by mail. For a mailed copy of a report, you may contact Petroleum Development Corporation, Investor Relations and Communications Department, P.O. Box 26, Bridgeport, WV 26330, or call toll free (800) 624-3821.

In addition to our SEC filings, other information, including our press releases, Bylaws, Committee Charters, Code of Business Conduct and Ethics, Shareholder Communication Policy, Board Nomination Procedures and the Whistleblower and Qualified Legal Compliance Committee Hotline, is also available at our website.

Business Strategy

Our primary objective is to continue to grow our reserves, production, net income and cash flow. To achieve meaningful increases in these key areas, we maintain an active drilling program that focuses on low risk development of our oil and natural gas reserves, limited exploratory drilling and the acquisition of producing properties with significant development potential.

Drill and Develop

Our acreage holdings include positions in the Rocky Mountain Region and the Appalachian, Michigan and Fort Worth Basins. In the Rocky Mountain Region, we focus on developmental drilling in Northeastern Colorado, or NECO, the Wattenberg Field (both located in the DJ Basin), the Grand Valley Field, Piceance Basin, and additional limited development in Burke County, North Dakota. We drilled 349 gross wells in 2007, compared to 231 gross wells in 2006. In addition, we seek to maximize the value of our existing wells through a program of well recompletions and refractures. During 2007, we recompleted and/or refractured a total of 181 wells compared to 43 in 2006.

We believe that we will be able to continue to drill a substantial number of new wells on our current undeveloped properties. As of December 31, 2007, we had leases or other development rights to approximately 200,000 acres, of which approximately 164,000 acres, or 82%, were in the Rocky Mountain Region. We plan to drill approximately 360 gross, 330 net, wells in 2008, excluding exploratory wells. We also plan to recomplete approximately 100 gross Wattenberg Field wells (Colorado) and 30 gross wells in the Appalachian Basin during 2008. To support future development activities we have conducted exploratory drilling in the past and will continue exploratory drilling plans in 2008. The goal of the exploration program is to develop several significant new areas for us to include in our future development drilling activity.

Strategically Acquire

Our acquisition efforts focus on producing properties that complement our existing operations and have a significant undeveloped acreage component. When weighing potential acquisitions, we prefer properties that have most of their value in producing wells, behind the pipe reserves or high quality proved undeveloped locations. Historically, acquisitions have offered efficiency improvements through economies of scale in management and administration costs. Since December 2006, we completed three acquisitions of assets or companies in our core operating area of the Wattenberg Field in Colorado, in addition to the acquisition of assets in southwestern Pennsylvania which are in close proximity to our existing assets in the Appalachian Basin. See Note 2, Acquisitions, to our consolidated financial statements included in this report.

Manage Risk

We seek opportunities to reduce the risk inherent to our business in the oil and natural gas industry by focusing our drilling efforts primarily on lower risk development wells and by maintaining positions in several different geographic regions and markets. Historically we have concentrated on development drilling and geographical diversification to reduce risk levels associated with natural gas and oil drilling, production and markets. Currently, a majority of our proved reserves are located in the Rocky Mountain Region due to our success in that area over the past several years. However, we benefit from operational diversity in the Rocky Mountain Region by maintaining significant activity and production in three separate areas, including the Grand Valley Field of the Piceance Basin in western Colorado, the Wattenberg Field in northern Colorado and the NECO area. Additionally, we regularly review opportunities to further diversify into other regions where we can apply our operational expertise. We believe development drilling will remain the foundation of our drilling activities in the future because it is less risky than exploratory drilling and is likely to generate cash returns more quickly. However, we expect that future activities may include a somewhat higher level of exploratory drilling in light of the increasing cost of accessing high-quality development opportunities and our ability, through increased size and financial strength, to pursue exploratory activities of greater significance. Additionally, exploratory activities have the potential to identify new development opportunities at a cost competitive to the current cost of acquiring proven locations.

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To help manage the risks associated with the oil and gas industry, we maintain a conservative financial approach and proactively employ strategies to reduce the effects of commodity price volatility. We have utilized asset sales to maximize cash for acquisitions, to reduce debt and preserve our financial flexibility. We also believe that successful oil and natural gas marketing is essential to risk management and profitable operations. To further this goal, we utilize Riley Natural Gas, or RNG, a wholly-owned subsidiary, to manage the marketing of our oil and natural gas and our use of oil and natural gas commodity derivatives as risk management tools. This allows us to maintain better control over third party risk in sales and derivative activities. We use oil and natural gas derivatives contracts, or hedges, in order to reduce the effects of volatile commodity prices. We currently have derivative contracts in place on a significant portion of our production; however, pursuant to our derivative policy, all volumes for derivatives contracts are limited to 80% of our estimated production for the future periods based only on proved developed producing production as defined in SEC reserve rules. As of March 3, 2008, we had oil and natural gas hedges in place covering 41% of our expected oil production and 62% of our expected natural gas production in 2008. Further, while our derivative instruments are utilized to hedge our oil and gas production, they do not qualify for use of hedge accounting under the terms of SFAS No. 133, resulting in the potential for significant earnings volatility. See Note 1, Summary of Significant Accounting Polices – Derivative Financial Instruments, to our consolidated financial statements included in this report.

Business Segments

We divide our operating activities into four segments:

- oil and gas sales;
- natural gas marketing;
- drilling and development; and
- well operations and pipeline income.

See Note 17, Business Segments, to our consolidated financial statements.

Oil and Gas Sales

Our oil and gas sales segment is our fastest growing business segment and reflects revenues and expenses from production and sale of natural gas and oil. We have interests in approximately 4,354 wells ranging from a few percent to 100%. During 2007, approximately 11% of our oil and gas sales revenue was generated by the Appalachian Basin, 6% by the Michigan Basin and 83% by Rocky Mountain Region. As of the end of 2007, our total proved reserves were located as follows: Appalachian Basin 15%, Michigan 4% and Rocky Mountain Region 81%. The majority of our undeveloped acreage is in the Rocky Mountain Region, where we focused our 2007 drilling activities. This segment represents approximately 78% of our income before income taxes for the year ended December 31, 2007.

Natural Gas Marketing

Our natural gas marketing segment is composed of our wholly owned subsidiary, RNG, through which we purchase, aggregate and resell natural gas produced by us and others. This allows us to diversify our operations beyond natural gas drilling and production. Through RNG, we have established relationships with many of the natural gas producers in the Appalachian Basin and we have gained significant expertise in the natural gas end-user market. We do not take speculative positions on commodity prices, and we employ derivative strategies to manage the financial effects of commodity price volatility. Our natural gas marketing segment represented approximately 7% of our income before income taxes for the year ended December 31, 2007.

Drilling and Development

Our drilling and development segment reflects results of drilling and development activities conducted for affiliated and non-affiliated parties. Historically, we have engaged in these activities primarily through sponsoring drilling partnerships, which allowed us to share the risks and costs inherent in drilling and development operations with our investor partners. In the future, we plan to evaluate the conduct of our drilling and development operations based on a comparison of the capital costs and risks associated with available financing alternatives. Beginning with our third sponsored drilling partnership in 2005, we have drilled partnership wells on a "cost-plus" basis, which means that we bill our investor partners for the actual drilling costs plus a fixed drilling fee. Prior to our cost-plus drilling arrangements, drilling was conducted on a "footage" basis; where the Company bore the risk of changes in costs. In addition, we have typically purchased a 20% to 37% working interest in the wells developed through these partnerships. In September 2006, we raised approximately $90 million through investor subscriptions in one drilling partnership, and in August 2007, we raised approximately $90 million through an additional drilling partnership.

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Our drilling and development segment represented approximately 18% of our income before income taxes for the year ended December 31, 2007. In January 2008, we announced that we do not plan to sponsor new drilling partnerships in 2008 in order to focus our effort on maximizing the value of the existing partnerships and our continuing growth through drilling and exploration. However, a portion of the funds available for drilling from the 2007 partnership were advanced and unexpended at the end of 2007, and they will be used to drill wells and the associated income will be recognized in 2008. With our plans not to sponsor a drilling partnership in 2008, we anticipate that its contribution to operating income to decline significantly in 2008.

Well Operations and Pipeline Income

We operate approximately 99% of the wells in which we own a working interest. With respect to wells in which we own an interest of less than 100%, we charge the other working interest owners a competitive fee for operating the well. Our well operations and pipeline income segment represented approximately 6% of our income before income taxes for the year ended December 31, 2007.

Areas of Operations

We focus our exploration, development and acquisition efforts in four geographic regions:

- Rocky Mountain Region;
- Appalachian Basin;
- Michigan Basin; and
- Fort Worth Basin.

During 2007, we generated approximately 84.1% of our production from Rocky Mountain Region wells, 9.8% of our production from Appalachian Basin wells, 6.1% of our production from Michigan Basin wells. Production operations have not commenced in the Fort Worth Basin. The majority of our undeveloped acreage is in the Rocky Mountain Region and our current drilling plans continue to be focused in that area.

Rocky Mountain Region. In 1999, we began operations in the Rocky Mountain Region, which includes our Colorado and North Dakota operations. The region is further divided into four operating areas; (1) Grand Valley Field, (2) Wattenberg Field, (3) NECO area and (4) North Dakota area. The Rocky Mountain Region includes approximately 310,000 gross acres of leasehold and approximately 2,117 oil and natural gas wells in which we own an interest (approximately 99% are operated by us). The general details of each area within the region are further outlined below:

- Grand Valley Field, Piceance Basin, Garfield County, Colorado. We commenced operations in the area in late 1999 and currently own an interest in 225 gross, 102.9 net, natural gas wells. Our leasehold position encompasses approximately 7,800 gross acres with approximately 3,900 net undeveloped acres remaining for development as of December 31, 2007. We drilled 53 gross, 41.7 net, wells in the area in 2007 and produced approximately 8.2 Bcfe net to our interests. Development wells drilled in the area range from 7,000 to 9,500 feet in depth and the majority of wells are drilled directionally from multi-well pads ranging from two to eight or more wells per drilling pad. The primary target in the area is gas reserves, developed from multiple sandstone reservoirs in the Mesaverde Williams Fork formation. Well spacing is approximately ten acres per well.

- Wattenberg Field, DJ Basin, Weld and Adams Counties, Colorado. We commenced operations in the area in late 1999 and currently own an interest in 1,242 gross, 747.6 net, oil and natural gas wells. Our leasehold position encompasses approximately 65,000 gross acres with approximately 13,100 net undeveloped acres remaining for development as of December 31, 2007. We drilled 158 gross, 106.1 net, wells in the area in 2007 and produced approximately 11.1 Bcfe net to our interests. Wells drilled in the area range from approximately 7,000 to 8,000 feet in depth and generally target oil and gas reserves in the Niobrara, Codell and J Sand reservoirs. Well spacing ranges from 20 to 40 acres per well. Operations in the area, in addition to the drilling of new development wells, includes the refrac of Codell and Niobrara reservoirs in existing wellbores whereby the Codell sandstone reservoir is re-stimulated or fraced a second time and/or initial completion attempts are made in the slightly shallower Niobrara carbonate reservoir.

- NECO area, DJ Basin, Yuma County Colorado and Cheyenne County, Kansas. We commenced operations in the area in 2003 and currently own an interest in 586 gross, 383.3 net, natural gas wells. Our leasehold position encompasses approximately 104,500 gross acres with approximately 55,300 net undeveloped acres remaining for development as of December 31, 2007. We drilled 123 gross, 115 net, wells in the area in 2007 and produced approximately 3.6 Bcfe net to our interests. Wells drilled in the area range from approximately 1,500 to 3,000 feet in depth and target gas reserves in the shallow Niobrara reservoir. Well spacing is approximately 40 acres per well. New drilling operations range from exploratory wells to test undrilled, seismically defined, structural features at the Niobrara horizon to development wells targeting known reserves in existing identified features.

- North Dakota, Burke County. We commenced operations in the area in 2006 and currently own an interest in 13 gross, 4.6 net, oil and natural gas wells. We divested the majority of our Bakken project acreage in late 2007 (see Note 16, Sale of Oil and Gas Properties, to our consolidated financial statements included in this report). Our remaining leasehold encompasses two project areas in Burke County and encompasses approximately 101,300 gross acres with approximately 60,000 net undeveloped acres remaining for development as of December 31, 2007. The eastern area acreage is prospective for development of oil and gas reserves in the Nesson Formation. Nesson development wells are approximately 6,000 feet in depth with single or multiple horizontal legs to 4,000 feet or more in length for a measured length of 10,000 feet or more per leg. The westernmost acreage block is undeveloped and includes approximately 22,746 gross and 18,607 net acres. The western project targets exploratory horizontal drilling to the Midale/Nesson Formation at depths of approximately 6,800 feet with a lateral leg component of up to 6,100. We drilled one unsuccessful vertical exploratory well in 2007 and anticipate additional exploratory activity in 2008.

Appalachian Basin. We have conducted operations in the Appalachian Basin since our inception in 1969. We own an interest in approximately 2,027 gross, 1,501.6 net, oil and natural gas wells in West Virginia, Pennsylvania, and Tennessee. We drilled 8 gross/net wells in the area in 2007 and produced approximately 2.7 Bcfe net to our interests. The majority of the West Virginia leasehold is developed on approximately 40 acre spacing. We are currently evaluating the results of an infill drilling project on a limited portion of our developed leasehold. Wells located in this area are approximately 4,500 feet deep and target predominantly gas reserves in Devonian and Mississippian aged tight sandstone reservoirs. The majority of our 10,000 net undeveloped acres was acquired through our Castle acquisition in October 2007. Development wells in this area target similar Devonian aged sands as in West Virginia, at depths ranging from 3,000 to 4,500 feet.

Michigan Basin. We began operations in the Michigan Basin in 1997 with the bulk of drilling activity occurring prior to 2002. We own an interest in approximately 209 gross, 145.6 net, oil and natural gas wells that produced 1.7 Bcfe net to our interest in 2007. Wells in the area range from 1,000 to 2,500 feet in depth and produce gas from the Antrim Shale. We drilled 3 gross and net wells in 2007.

Fort Worth Basin, Erath County, Texas. We have an interest in approximately 10,800 gross, 8,900 net acres, in northeastern Erath County. The leasehold acreage is prospective for the development of oil and natural gas reserves in the Barnett Shale formation at depths of approximately 5,000 feet. Development is typically with a horizontal component of approximately 3,000 feet or more, resulting in an approximate measured length of up to 8,000 feet or more in this area. As of December 31, 2007, we have drilled one exploratory Barnett well to total depth. The exploratory well was pending determination at December 31, 2007, see Note 4, Properties and Equipment - Suspended Well Costs. Completion operations have not commenced as we are awaiting the completion of a third party gas gathering infrastructure.

The table below sets forth our productive wells by operating area at December 31, 2007.

Productive Wells

		Gas		Oil
Location	Gross			