

PETROLEUM DEVELOPMENT CORP  
Form 10-K  
May 23, 2007

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

**FORM 10-K**

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

For the fiscal year ended December 31, 2006

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  
(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

**Securities Registered Pursuant to Section 12(b) of the Act:**

<b>Title of each class</b>	<b>Name of exchange on which registered</b>
<b>Common Stock, par value \$.01 per share</b>	<b>NASDAQ Global Select Market</b>

**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  T

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  T

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the

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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 T No

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. T

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

Large Accelerated Filer

Accelerated Filer T

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 T

As of April 30, 2007, 14,887,530 shares of the Registrant's Common Stock were issued and outstanding.

The aggregate market value of such shares held by non-affiliates of the Registrant on June 30, 2006, the last business day of the Registrant's most recently completed second quarter was \$610,385,733 (based on the last traded price of \$37.70).

DOCUMENTS INCORPORATED BY REFERENCE

None.

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**GLOSSARY OF TERMS**

The following are abbreviations and definitions of terms commonly used in the oil and gas industry and this Form 10-K.

**Bbl** - One barrel, or 42 U.S. gallons of liquid volume.

**Bcf** - One billion cubic feet.

**Bcfe** - One billion cubic feet of natural gas equivalents.

**Completion** - The installation of permanent equipment for the production of oil or gas.

**Credit Facility** - A line of credit provided by a group of banks, secured by oil and gas properties.

**DD&A** - Refers to depreciation, depletion and amortization of the Company's property and equipment.

**Development well** - A well drilled within the proved area of an oil or gas reservoir to the depth of a stratigraphic horizon known to be productive.

**Division order** - A contract setting forth the interest of each owner of an oil and gas property, and serves as the basis on which the purchasing company pays each owner's respective share of the proceeds of the oil and gas purchased.

**Dry hole** - A well found to be incapable of producing hydrocarbons in sufficient quantities to justify completion as an oil or gas well.

**Exploratory well** - A well drilled to find and produce oil or natural gas reserves not classified as proved, to find a new productive reservoir in a field previously found to be productive of oil or natural gas in another reservoir or to extend a known reservoir.

**Extensions and discoveries** - As to any period, the increases to proved reserves from all sources other than the acquisition of proved properties or revisions of previous estimates.

**Gross acres or wells** - Refers to the total acres or wells in which the Company has a working interest.

**Horizontal drilling** - A drilling technique that permits the operator to contact and intersect a larger portion of the producing horizon than conventional vertical drilling techniques and may, depending on the horizon, result in increased production rates and greater ultimate recoveries of hydrocarbons.

**MBbls** - One thousand barrels.

**Mcf** - One thousand cubic feet.

**Mcfe** - One thousand cubic feet of natural gas equivalents, based on a ratio of 6 Mcf for each barrel of oil, which reflects the relative energy content.

**MMbtu** - One million British thermal units. One British thermal unit is the heat required to raise the temperature of a one-pound mass of water from 58.5 to 59.5 degrees Fahrenheit.

**MMcf** - One million cubic feet.

**MMcfe** - One million cubic feet of natural gas equivalents.

**Natural gas liquids** - Liquid hydrocarbons that have been extracted from natural gas, such as ethane, propane, butane and natural gasoline.

**Net acres or wells** - Refers to gross acres or wells multiplied, in each case, by the percentage working interest owned by the Company.

**Net production** - Oil and gas production that is owned by the Company, less royalties and production due others.

**NYMEX** - New York Mercantile Exchange, the exchange on which commodities, including crude oil and natural gas futures contracts, are traded.

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**Oil** - Crude oil or condensate.

**Operator** - The individual or company responsible for the exploration, development and production of an oil or gas well or lease.

**Present value of proved reserves** - The present value of estimated future revenues, discounted at 10% annually, to be generated from the production of proved reserves determined in accordance with Securities and Exchange Commission guidelines, net of estimated production and future development costs, using prices and costs as of the date of estimation without future escalation, without giving effect to (i) estimated future abandonment costs, net of the estimated salvage value of related equipment, (ii) non-property related expenses such as general and administrative expenses, debt service and future income tax expense, or (iii) depreciation, depletion and amortization.

**Proved developed non-producing reserves** - Reserves that consist of (i) proved reserves from wells which have been completed and tested but are not producing due to lack of market or minor completion problems which are expected to be corrected and (ii) proved reserves currently behind the pipe in existing wells and which are expected to be productive due to both the well log characteristics and analogous production in the immediate vicinity of the wells.

**Proved developed producing reserves** - Proved reserves that can be expected to be recovered from currently producing zones under the continuation of present operating methods.

**Proved developed reserves** - The combination of proved developed producing and proved developed non-producing reserves.

**Proved reserves** - The estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

**Proved undeveloped reserves ("PUD")** - Proved reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

**Recompletion** - A recompletion occurs when the producer reenters a well to complete (i.e., perforate) a new formation from that in which a well has previously been completed.

**Royalty** - An interest in an oil and gas lease that gives the owner of the interest the right to receive a portion of the production from the leased acreage (or of the proceeds of the sale thereof), but generally does not require the owner to pay any portion of the costs of drilling or operating the wells on the leased acreage. Royalties may be either landowner's royalties, which are reserved by the owner of the leased acreage at the time the lease is granted, or overriding royalties, which are usually reserved by an owner of the leasehold in connection with a transfer to a subsequent owner.

**SEC** - The United States Securities and Exchange Commission.

**Standardized measure of discounted future net cash flows** - Present value of proved reserves, as adjusted to give effect to (i) estimated future abandonment costs, net of the estimated salvage value of related equipment, and (ii) estimated future income taxes.

**Tcf** - One trillion cubic feet.

**Undeveloped acreage** - Leased acreage on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil and gas, regardless of whether such acreage contains proved reserves.

**Working interest** - An interest in an oil and gas lease that gives the owner of the interest the right to drill for and produce oil and gas on the leased acreage and requires the owner to pay a share of the costs of drilling and production operations. The share of production to which a working interest is entitled will be smaller than the share of costs that the working interest owner is required to bear to the extent of any royalty burden.

**Workover** - Operations on a producing well to restore or increase production.

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**PART I**

**ITEM 1: BUSINESS**

Petroleum Development Corporation is an independent energy company engaged primarily in the development, production and marketing of natural gas and oil. Since it began oil and gas operations in 1969, the Company has grown primarily through drilling and development activities, the acquisition of producing natural gas and oil wells and the expansion of its natural gas marketing activities. As of December 31, 2006, the Company has interests in approximately 3,100 wells located in the Rocky Mountain Region, Appalachian Basin and Michigan with gross proved reserves of 719 billion cubic feet equivalent of natural gas ("Bcfe", based on one barrel of oil equaling six thousand cubic feet equivalent of natural gas ("Mcf")) of which the Company's share is 323 Bcfe. The Company's share of production for the fourth quarter of 2006 averaged 52,000 Mcfe per day.

Unless the context otherwise requires, the terms "PDC" or "Company" refer to Petroleum Development Corporation, its subsidiaries and proportionately consolidated drilling partnerships, collectively. The Company's corporate headquarters are located at 120 Genesis Boulevard, Bridgeport, West Virginia 26330 where the telephone number is (304) 842-3597.

***Business Segments***

The Company's operations are divided into four segments for management and reporting purposes: (1) drilling and development, (2) natural gas marketing, (3) oil and gas sales and (4) well operations and pipeline income. See Note 17 to the consolidated financial statements.

***Drilling and Development***

The Company drills wells not only for itself, but also for its investor partners. When the Company drills wells for others it earns profit above the cost of the wells. Beginning with the last Company-sponsored partnership of 2005 (for which revenue generating activities did not commence until early 2006), partnership wells are drilled on a "cost-plus" basis, where the Company bills investors for the actual cost of the wells plus an agreed upon mark-up above the costs. Prior to that, most of the Company's third-party drilling activities were conducted on a footage-based basis, where the Company drills the wells for a fixed price per foot drilled with additional chargeable items per the drilling agreement.

Since 1984, the Company has sponsored limited partnerships formed to engage in drilling operations. The Company typically purchases a 20% to 37% ownership working interest in these drilling limited partnerships. In 2006, the Company, through one private drilling partnership, raised approximately \$90 million in investor subscriptions, making it one of the largest sponsors of oil and gas partnership programs in the United States, as it has been for the last several years. PDC's working interest is 37% in the 2006 partnership. Through the partnerships, the Company has been able to expand its drilling opportunities, reduce its drilling risk through greater diversification, and share the costs of the infrastructure necessary to support such activities.

***Natural Gas Marketing***

The Company's wholly-owned subsidiary, Riley Natural Gas ("RNG"), purchases, aggregates and resells natural gas developed by the Company and other producers. This allows the Company to diversify its operations beyond natural gas drilling and production. RNG has established relationships with many of the natural gas producers in the Appalachian Basin and has significant expertise in the natural gas end-user market. In addition, RNG has extensive experience in the use of risk management strategies, which the Company utilizes to help manage the financial impact of changes in the price of natural gas and oil on the Company and its partnerships. RNG also manages the marketing



of oil and gas for the Company's wells outside the Appalachian Basin, but does not market gas or oil for the non-affiliated producers in those areas.

***Oil and Gas Sales***

Revenue and expenses from the production and sale of oil and natural gas from the Company's interests in oil and gas wells is reported in this segment. The Company has interests in approximately 3,100 wells ranging from a few percent to 100%. During 2006, approximately 9% of the Company's production was generated by Appalachian Basin wells, 8% by Michigan Basin wells and 83% by Rocky Mountain Region wells. As of the end of 2006, the Company's total proved reserves were located as follows: Appalachian Basin (11%), Michigan (7%) and Rocky Mountain Region (82%). The majority of the Company's undeveloped acreage is in the Rocky Mountain Region and the Company's planned drilling for 2007 will be focused in that area. See Note 3 to the consolidated financial statements for disclosure of significant customers.

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***Well Operations and Pipeline Income***

The Company operates approximately 95% of the wells in which it owns an interest. When the Company owns less than 100% of the working interest in a well, it charges the other owners a competitive fee for operating the well. These revenues and the associated costs are reflected in the Well Operations segment.

***Areas of Operations***

The Company's operations are divided into three regions: the Appalachian Basin, Michigan, and the Rocky Mountain Region. The Company has conducted operations in the Appalachian Basin since its inception in 1969, in Michigan since 1997, and in the Rocky Mountain Region since 1999. The Company includes its North Dakota operations in the Rocky Mountain Region.

In all three regions, the Company has historically targeted developmental natural gas reserves at depths of less than 10,000 feet. In some areas of the Rocky Mountain Region, Michigan and the Appalachian Basin, the wells also produce oil in conjunction with natural gas. Recently the Company has begun to drill to progressively deeper targets in the Rocky Mountain Region. In particular, the Company has drilled several wells with depths of more than 12,000 feet and horizontal wells with a total drilled footage approaching 20,000 feet. The Company's management believes these deeper and horizontal wells, although more expensive to drill, offer attractive economics and reserves. The probability of encountering problems when drilling wells at depths greater than 12,000 feet or horizontally is generally greater than when drilling a vertical well of lesser depth. With increasing costs for and declining availability of proved developed drilling locations, the Company's management believes the additional risk associated with exploratory drilling is justified by the potential to generate additional proved locations at a significantly lower cost than would be required to purchase proved undeveloped locations.

***Business Strategy***

The Company's primary objective is to increase shareholder value by expanding its oil and natural gas reserves, production and revenues through a strategy that includes the following key elements:

***Drill and Develop***

Drilling developmental natural gas wells has been the mainstay of the Company's drilling program for a number of years. The Company drilled 231 wells in 2006, compared to 242 wells in 2005. In addition, the Company seeks to maximize the value of its existing wells through a program of well recompletions. The Company's management believes that it will be able to drill a substantial number of new wells on its current undeveloped leased properties. As of December 31, 2006, the Company had leases or other development rights to 200 undeveloped acres in the Michigan Basin, 12,800 undeveloped acres in the northern Appalachian Basin and 187,500 undeveloped acres in the Rocky Mountain Region. The Company also plans to recomplete about 164 Wattenberg Field wells (Colorado) during 2007.

To support future development activities the Company has conducted exploratory drilling in the past and will continue exploratory drilling plans in 2007. The goal of the exploration program is to develop several significant new areas for the Company to include in its future development drilling activity.

***Acquire***

The Company's acquisition efforts are focused on producing properties that fit well within existing operations or in areas where the Company is establishing new operations. Preferred properties have most of their value in producing wells, behind pipe reserves or high quality proved undeveloped locations. Acquisitions have historically offered

economies in management and administration costs, and the Company's management believes that with its growing operations staff it can acquire and manage more producing wells without incurring substantial increases in its administrative costs. See Notes 2, 15 and 16 to Consolidated Financial Statements.

*Diversify and Focus*

With operations in the Rocky Mountains, Michigan and the Appalachian Basin, the Company has proven its ability to grow through operations in geographically diverse areas. While these areas provide geographic diversification, within each area, the Company has concentrated positions that lend themselves to effective development and operation. The Company plans to conduct the majority of its drilling activities in the Rocky Mountain Region during 2007, but will continue to seek additional opportunities for expansion in areas where the Company's experience and expertise can be applied successfully.

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***Manage Risk***

The Company seeks opportunities to reduce the risks inherent in the oil and gas industry in a variety of ways. For a number of years, an integral part of the Company's strategy has been to concentrate on development drilling and geographical diversification to reduce risk levels associated with natural gas and oil drilling, production and markets. Development drilling is less risky than exploratory drilling and is likely to generate cash returns more quickly. Development drilling will remain the foundation of the Company's drilling activities in 2007. However, the Company's management believes the increasing cost of high quality development locations has made exploratory drilling relatively more attractive for future efforts. Exploratory wells have the potential of identifying new development opportunities at a significantly lower cost than the current cost of acquiring proven locations. While successful exploratory efforts could add to the Company's future drilling opportunities at favorable costs, under the successful efforts method of accounting, exploratory dry holes are expensed at the time it is recognized that they are unproductive. This could result in greater short-term expenses and a reduction in the near-term profitability of the Company.

To help offset the relatively high business risk inherent in the oil and gas industry the Company maintains a conservative financial structure. The Company's management believes that successful natural gas marketing is essential to risk management and profitable operations in a deregulated gas market. To further this goal, the Company utilizes RNG to manage the marketing of the Company's oil and natural gas and its use of oil and gas commodity derivatives as risk management tools. This allows the Company to maintain better control over third party risk in sales and derivative activities. The Company uses natural gas and oil derivatives to reduce the effects of volatile energy prices.

***Available Information Posted on the Company's Website***

The Company files Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, registration statements and other items with the Securities and Exchange Commission ("SEC"). PDC provides free access to all of these SEC filings, as soon as reasonably practicable after filing, on its internet site located at [www.petd.com](http://www.petd.com). The Company will also make available to any shareholder, without charge, a copy of its Annual Report on Form 10-K as filed with the SEC. For a copy of the Company's Annual Report, or any other filings, please 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 the Company's SEC filings, other information, including the Company's press releases, current drilling program sales, 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 the Company's internet site, [www.petd.com](http://www.petd.com).

The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site ([www.sec.gov](http://www.sec.gov)) that contains reports, proxies, information statements and other information regarding issuers, like PDC, that file electronically with the SEC.

***Natural Gas Industry Overview***

Natural gas is one of the largest energy sources in the United States. The estimated 21.9 Tcf of natural gas consumed in 2006 represented approximately 22% of the total energy used in the United States. Natural gas is consumed in the United States as follows: 35% by industrial end-users as feedstock for products such as plastic and fertilizer or as the

energy source for producing products such as glass; 21% and 14% by residential and commercial end-users, respectively, for uses including heating, cooling and cooking; 28% by utilities for the generation of electricity; and 2% for other users. (Source U.S. Energy Information Administration)

The Company's management believes that the market for natural gas will continue to grow in the future. Natural gas burns cleaner than most fossil fuels and produces less greenhouse gas per unit of energy released. Relative to other energy sources, natural gas usage and losses during transportation from source to destination are slight, averaging only about 2% of the natural gas energy. The delivery of natural gas is among the safest means of distributing energy to customers, as the natural gas transmission system is fixed and is located underground.

The deregulation of the natural gas industry and a favorable regulatory environment have resulted in end-users' ability to purchase natural gas on a competitive basis from a greater variety of sources. Increasing international demand for petroleum combined with supply constraints kept oil prices near record high levels throughout 2006. Continuing increases in world energy demand appear likely in 2007 and beyond. This makes natural gas more competitive in domestic markets as a replacement for oil and increases the value of domestic oil and natural gas reserves.

The Company's management believes that the foregoing factors, together with the increased availability of natural gas as a form of energy for residential, commercial and industrial uses, should increase the demand for natural gas as well as create new markets for natural gas, even at prices that are high by historical standards.

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Because local supplies of natural gas are inadequate to meet demand in some sections of the United States, areas including the West Coast and the Northeast import natural gas from producing areas via interstate natural gas pipelines. The cost of transporting natural gas from the major producing areas to markets creates a price advantage for production located closer to the consuming regions. Natural gas producers in the Appalachian Basin and Michigan benefit from proximity to the Northeastern and Midwestern United States markets.

In contrast, much of the production in the Rocky Mountains is transported significant distances to end user markets. As a result, the price received for gas in the Rocky Mountains is generally less than the price received in areas closer to the primary consuming areas. The Rocky Mountain Region is believed to hold substantial undeveloped natural gas resources. Recent and planned additions to pipeline capacity in the region have made the area more attractive for development. Although in the near term, gas from the region will generally sell for less than gas in the Appalachian and Michigan Basins, development costs per Mcfe may be less.

## *Operations*

### **Exploration and Development Activities**

The Company's development activities focus on the identification and drilling of new productive wells, the acquisition of existing producing wells from other operators, and maximizing the value of the Company's current properties through infill drilling, recompletions, and other production enhancements.

### **Prospect Generation**

The Company's staff of professional geologists is responsible for identifying areas with potential for economic production of natural gas and oil. These geologists have decades of cumulative experience evaluating prospects and drilling natural gas and oil wells. They utilize results from logs, seismic data and other tools to evaluate existing wells and to predict the location of economically attractive new natural gas and oil reserves. To further this process, the Company has collected and continues to collect logs, core data, production information and other raw data available from state and private agencies, other companies and individuals actively drilling in the regions being evaluated. From this information the geologists develop models of the subsurface structures and formations that are used to predict areas for prospective economic development.

On the basis of these models, the Company's land department obtains available natural gas and oil leaseholds, farmouts and other development rights in these prospective areas. In most cases to secure a lease, the Company pays a lease bonus and annual rental payments, converting, upon initiation of production, to a royalty. In addition, overriding royalty payments may be made to third parties in conjunction with the acquisition of drilling rights initially leased by others. As of December 31, 2006, the Company had leasehold rights to approximately 200,500 acres available for development. See "Properties--Oil and Natural Gas Leases."

### **Drilling Activities**

When prospects have been identified, leased and all regulatory approvals obtained, the Company develops these properties by drilling wells. In 2006, the Company drilled a total of 222 development wells, which 216 wells were designated successful. As of December 31, 2006, 82 of the 216 successful wells were awaiting gas pipeline connection. As of April 30, 2007, 67 of the wells awaiting pipeline connection were connected and turned in line. Typically, the Company will act as driller-operator for these prospects, frequently selling interests in the wells to Company-sponsored partnerships and other entities that are interested in exploration or development of the prospects. The Company retains a working interest in each well it drills.

The Company also drilled nine exploratory wells in 2006, eight (including one pending determination as of December 31, 2006) were determined to be productive and one was determined to be dry. Costs related to the dry hole of \$1.3 million were expensed in 2006. The Company plans to conduct additional exploratory drilling activities in 2007. See "Financing of Company Drilling and Development Activities" and "Drilling and Development Activities Conducted for Company Sponsored Partnerships" for additional discussion regarding the Company's drilling activities.

Much of the work associated with drilling, completing and connecting wells, including drilling, fracturing, logging and pipeline construction is performed under the Company's direction by subcontractors specializing in those operations, as is common in the industry. When judged advantageous, material and services used by the Company in the development process are acquired through competitive bidding by approved vendors. The Company also directly negotiates rates and costs for services and supplies when conditions indicate that such an approach is warranted.

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The following tables summarize the Company's development and exploratory drilling activity for the last five years. There is no correlation between the number of productive wells completed during any period and the aggregate reserves attributable to those wells.

	Development Wells Drilled					
	Total		Productive		Dry	
	Drilled	Net	Drilled	Net	Drilled	Net
2002	70	13.7	70	13.7	-	-
2003	110	28.5	110	28.5	-	-
2004	157	43.0	153	42.4	4	0.6
2005	234	103.4	232	102.0	2	1.4
<b>2006</b>	<b>222</b>	<b>134.4</b>	<b>216</b>	<b>129.8</b>	<b>6</b>	<b>4.6</b>
Total	793	323.0	781	316.4	12	6.6

	Exploratory Wells Drilled					
	Total		Productive		Dry	
	Drilled	Net	Drilled	Net	Drilled	Net
2002	-	-	-	-	-	-
2003	1	1.0	-	-	1	1.0
2004	1	1.0	-	-	1	1.0
2005	8	7.3	3	2.3	5	5.0
<b>2006</b>	<b>9</b>	<b>3.3</b>	<b>8</b>	<b>2.8</b>	<b>1</b>	<b>0.5</b>
Total	19	12.6	11	5.1	8	7.5

**Financing of Company Drilling and Development Activities**

The Company conducts development drilling activities for its own account and acts as operator for other owners. When conducting activities for its own account, the Company uses cash flow from operations and capital provided from its long term credit facility to fund its share of operations.

**Drilling and Development Activities Conducted for Company Sponsored Partnerships**

In addition to wells and interests in wells that it drills for itself, the Company also acts as operator for other oil and gas owners. Historically, these other owners have included individuals, corporations, partnerships formed by non-affiliated parties and other investors. Currently, the Company's drilling partners consist primarily of public and private partnerships sponsored by the Company. The Company contributes a cash investment to purchase an interest in the drilling and development activities and serves as the managing general partner for each partnership; accordingly, the Company is subject to substantial cash commitments at the closing of each drilling partnership.

In 1984, the Company began sponsoring drilling partnerships. The Company-sponsored partnerships had \$90 million in subscriptions in 2006, \$116 million in subscriptions in 2005, and \$100 million in subscriptions in 2004. During 2006, the Company sponsored one drilling partnership to which it contributed \$38.9 million and received a 37% working interest in the partnership. While funds were received by the Company pursuant to drilling contracts in the years indicated, the Company recognizes revenues from drilling operations on the percentage of completion method as the wells are drilled, rather than when funds are received. Substantially all of the Company's drilling and development funds are now received from partnerships in which the Company serves as managing general partner. However, because wells produce for a number of years, the Company continues to serve as operator for a number of unaffiliated parties. The Company plans to offer \$110 million in subscriptions through a private placement in 2007.



The Company enters into a development agreement with an investor partner, pursuant to which the Company agrees to sell some or all of its rights in a well to be drilled to the partnership or other entity. The partnership or other entity thereby becomes owner of a working interest in the well.

The Company's drilling contracts with its investor partners have historically taken many different forms. Beginning with the last Company-sponsored partnership of 2005 (for which revenue generating activities did not commence until early 2006), partnership wells are drilled on a "cost-plus" basis, whereby the Company bills investors for the actual cost of the wells plus an agreed upon mark-up above the costs. In the past the drilling contracts could be classified as on a footage-based rate, whereby the Company received drilling and completion payments based on the depth of the well. The Company may also purchase an additional working interest in the partnership properties. In its financial reporting, the Company reports only its proportionate share of oil and gas reserves, production, oil and gas sales and costs associated with wells in which other investors participate. The level of the Company's drilling and development activity is dependent upon the amount of subscriptions in its public drilling partnerships and investments from other partnerships or other joint venture partners. Accepting investments from third party investors and Company sponsored partnerships enables the Company to diversify its holdings, thereby reducing the risk of the Company's investments. The Company's management believes that investments in drilling activities, whether through Company-sponsored partnerships or other sources, are influenced in part by the favorable treatment that such limited partner investments receive under the federal income tax laws. No assurance can be given that the Company will continue to have access to funds generated through these financing vehicles or that the favorable tax treatment will continue.

Index**Purchases of Producing Properties**

In addition to drilling new wells, the Company continues to pursue opportunities to purchase existing wells from other owners, as well as greater ownership interests in the wells it operates. Generally, outside interests purchased include a majority interest in the wells and the right to operate the wells. During 2006, the Company successfully acquired the stock of Unioil, Inc., a small independent producer with properties primarily in the Wattenberg Field in Colorado, for a total of \$18.6 million. In addition, in January 2007, the Company completed the purchase of approximately 144 oil and gas wells and 8,160 acres of leaseholds in the Wattenberg Field from EXCO Resources. Also in January 2007, the Company purchased the outside partnership interests in 44 partnerships which had been formed primarily in the late 1980s and 1990s. These interests constituted the majority of the interests in 718 wells, primarily in the Appalachian and Michigan Basins. In February 2007, the Company acquired 28 producing wells and associated undeveloped acreage in Colorado for \$11.8 million.

**Production**

The following table shows the Company's net production in thousands of barrels ("MBbl") of crude oil and in million cubic feet ("MMcfe") of natural gas and the costs and weighted average selling prices of oil in barrels (Bbl) and gas in thousands of cubic feet (Mcf).

	Year Ended December 31,					
	2006	2005	2004	2003	2002	
Production (1):						
Oil (MBbl)	<b>631</b>	439	381	289	227	
Natural Gas (MMcfe)	<b>13,161</b>	11,031	10,372	8,712	6,462	
Equivalent (MMcfe) (2)	<b>16,949</b>	13,665	12,659	10,449	7,824	
Average sales price:						
Oil (per Bbl) (3)	\$ <b>59.33</b>	\$ 50.56	\$ 38.00	\$ 29.43	\$ 24.41	
Natural gas (per Mcf) (3)	\$ <b>5.91</b>	\$ 7.29	\$ 5.30	\$ 4.58	\$ 2.65	
Equivalent average sales price (per Mcfe)	\$ <b>6.80</b>	\$ 7.51	\$ 5.49	\$ 4.63	\$ 2.90	
Average production cost (lifting cost)						
Per equivalent (Mcf) (4)	\$ <b>1.23</b>	\$ 1.19	\$ 1.12	\$ 0.93	\$ 0.76	

(1) Production as shown in the table is net to the Company and is determined by multiplying the gross production volume of properties in which the Company has an interest by the percentage of the leasehold or other property interest owned by the Company.

(2) A ratio of energy content of natural gas and oil (six Mcf of natural gas equals one barrel of oil) was used to obtain a conversion factor to convert oil production into equivalent Mcf of natural gas.

(3) The Company utilizes commodity based derivative instruments to manage a portion of its exposure to price volatility of its natural gas and oil sales. The above table does not include the results of derivative transactions.

(4) Production costs represent oil and gas operating expenses which include severance and ad valorem taxes as reflected in the financial statements of the Company. See "Oil and Gas Production and Well Operations Costs" in Management's Discussion and Analysis.

**Natural Gas Sales**

Natural gas produced by the Company's well interests is generally sold under contracts with monthly pricing provisions. Virtually all of the Company's contracts include provisions wherein prices change monthly with changes in the market with certain adjustments based on, among other factors, whether a well delivers to a gathering or transmission line, quality of natural gas and prevailing supply and demand conditions, so that the price of the natural gas fluctuates to remain competitive with other available natural gas supplies. As a result, the Company's revenues from the sale of natural gas will suffer if market prices decline and benefit if they increase. The Company's management believes that the pricing provisions of its natural gas contracts are customary in the industry.

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The Company sells its natural gas to industrial end-users, utilities, other gas marketers, and other wholesale gas purchasers. During 2006, natural gas produced by the Company was sold at prices ranging from \$2.26 to \$15.70 per Mcf, depending upon well location, the date of the sales contract and other factors. The weighted net average price of natural gas sold by the Company during 2006 was \$5.91 per Mcf.

In general, the Company, together with its marketing subsidiary, RNG, has been and expects to continue to be able to produce and sell natural gas from its wells without significant curtailment by providing natural gas to purchasers at competitive prices. Open access transportation through the country's interstate pipeline system makes a broad range of markets accessible to the Company. Whenever feasible, the Company obtains access to multiple pipelines and markets from each of its gathering systems seeking the best available market for its natural gas at any point in time.

## **Oil Sales**

The majority of the Company's wells in the Wattenberg Field in Colorado and the Company's North Dakota wells produce oil in addition to natural gas. As of December 31, 2006, oil represented about 13% of the Company's total equivalent reserves and accounted for approximately 33% of the Company's oil and gas sales for the year ended December 31, 2006.

The Company is currently able to sell all the oil that it can produce under existing sales contracts with petroleum refiners and marketers. The Company does not refine any of its oil production. The Company's crude oil production is sold to purchasers at or near the Company's wells under short-term purchase contracts. During 2006, oil produced by the Company sold at prices ranging from \$53.75 to \$71.77 per barrel, depending upon the location and quality of oil. In 2006, the weighted net average price per barrel of oil sold by the Company was \$59.33.

Oil production is subject to many of the same operating hazards and environmental concerns as natural gas production, but is also subject to the risk of oil spills. Federal regulations require certain owners or operators of facilities that store or otherwise handle oil, including the Company, to procure and implement Spill Prevention, Control and Counter-measures ("SPCC") plans relating to the possible discharge of oil into surface waters. The Oil Pollution Act of 1990 ("OPA") subjects owners of facilities to strict joint and several liability for all containment and cleanup costs and certain other damages arising from oil spills. Noncompliance with OPA may result in varying civil and criminal penalties and liabilities. Operations of the Company are also subject to the Federal Clean Water Act and analogous state laws relating to the control of water pollution, which laws provide varying civil and criminal penalties and liabilities for release of petroleum or its derivatives into surface waters or into the ground.

## **Natural Gas Marketing**

The Company's natural gas marketing activities involve the purchase of natural gas from other producers and the sale of that natural gas along with natural gas produced by the Company. The Company's management believes that in a deregulated market, successful natural gas marketing is an essential component of profitable operations. A variety of factors affect the market for natural gas, including the availability of other domestic production, natural gas imports, the availability and price of alternative fuels, the proximity and capacity of natural gas pipelines, general fluctuations in the supply and demand for natural gas, and the effects of state and federal regulations on natural gas production and sales. The natural gas industry also competes with other industries in supplying the energy and fuel requirements of industrial, commercial and individual customers.

RNG, a wholly owned subsidiary, is a natural gas marketing company that specializes in the purchase, aggregation and sale of natural gas production in the Company's Eastern operating areas. RNG markets natural gas produced by the Company and also purchases natural gas from other producers and resells to utilities, end users or other marketers. The employees of RNG have extensive knowledge of natural gas markets in the Company's areas of operations. Such

knowledge assists the Company in maximizing its prices as it markets natural gas from Company-operated wells. The gas is marketed to natural gas utilities, industrial and commercial customers as well as other marketers, either directly through the Company's gathering system, or utilizing transportation services provided by regulated interstate pipeline companies.

### **Commodity Risk Management Activities**

The Company utilizes commodity based derivative instruments to manage a portion of the exposure to price volatility stemming from its oil and natural gas sales and marketing activities. These instruments consist of over the counter swaps and options and NYMEX-traded natural gas futures and option contracts for Appalachian and Michigan production and Colorado Interstate Gas Index ("CIG") and Panhandle Eastern Pipeline ("PEPL")-based contracts for Colorado natural gas production and NYMEX traded oil futures and option contracts for Colorado oil production. The Company may utilize derivatives based on other indices or markets where appropriate. The contracts economically provide price protection for committed and anticipated natural gas purchases and sales and anticipated oil sales, generally forecasted to occur within the next two to three year period. Company policy prohibits the use of natural gas or oil futures or options for speculative purposes and permits utilization of derivatives only if there is an underlying physical position.

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RNG has extensive experience with the use of cash-settled derivatives to reduce the risk and impact of natural gas price changes. These financial derivatives are used by RNG to coordinate fixed purchases and sales, and by the Company to establish "floors" and "ceilings" or "collars" on the possible range of the prices realized for the sale of natural gas and oil. RNG also enters into back-to-back fixed-price purchases and sales contracts with counterparties. These fixed physical contracts meet the FAS 133 definition of a derivative. Both types of derivatives (i.e., the physical deals and the cash settled contracts) are carried on the balance sheet at fair value with changes in fair values recognized currently in the income statement.

The Company is subject to price fluctuations for natural gas sold in the spot market and under market index contracts. The Company continues to evaluate the potential for reducing these risks by entering into derivative transactions. In addition, the Company may close out any portion of derivatives that may exist from time to time which may result in a realized gain or loss on that derivative transaction. The Company economically manages the price risk on only a portion of its anticipated production, so some of the production is subject to the full fluctuation of market pricing.

## **Well Operations**

At December 31, 2006, the Company had an interest in approximately 1,365 wells in the Appalachian Basin, 206 wells in the Michigan Basin and 1,530 wells in the Rocky Mountain Region. The Company's ownership interest in these wells ranges from greater than 0% to 100% and, on average, the Company has an approximate 51.4% ownership interest in the wells it operates.

The Company is paid a monthly operating fee for each well it operates for the portion of these wells owned by others, including the limited partnerships sponsored by the Company. The fee is competitive with rates charged by other operators in the area. The fee covers monthly operating and accounting costs, insurance and other recurring costs. The Company may also receive additional compensation, at competitive rates, for special non-recurring activities, such as reworks and recompletions.

## **Transportation**

Natural gas wells are connected by pipelines to natural gas markets. Over the years, the Company has developed, owns and operates gathering systems in some of its areas of operations. The Company also continues to construct new trunk lines as necessary to provide for the marketing of natural gas being developed from new areas and to enhance or maintain its existing systems.

## **Governmental Regulation**

While the price of natural gas is set by the market, other aspects of the Company's business and the natural gas industry in general are heavily regulated. The availability of a ready market for natural gas production depends on several factors beyond the Company's control. These factors include regulation of natural gas production, federal and state regulations governing environmental quality and pollution control, the amount of natural gas available for sale, the availability of adequate pipeline and other transportation and processing facilities and the marketing of competitive fuels. State and federal regulations generally are intended to protect consumers from unfair treatment, control and reduce the risk to the public and workers from the drilling, completion, production and transportation of oil and natural gas, prevent waste of natural gas, protect rights to produce natural gas between owners in a common reservoir and control contamination of the environment. Pipelines are subject to the jurisdiction of various federal, state and local agencies. In the western part of the United States, the federal and state governments own a large percentage of the land and the rights to develop oil and natural gas. Recently the Company has increased its positions in these types of leases. Generally, government leases are subject to additional regulations and controls not commonly seen on private leases. The Company takes the steps necessary to comply with applicable regulations both on its own

behalf and as part of the services it provides to its investor partnerships. The Company's management believes that it is in compliance with such statutes, rules, regulations and governmental orders, although there can be no assurance that this is or will remain the case. The following discussion of the regulation of the United States natural gas industry is not intended to constitute a complete discussion of the various statutes, rules, regulations and environmental orders to which the Company's operations may be subject.

### **Regulation of Oil and Natural Gas Exploration and Production**

The Company's exploration and production business is subject to various federal, state and local laws and regulations on taxation, the development, production and marketing of oil and gas, and environmental and safety matters. Many laws and regulations require drilling permits and govern the spacing of wells, rates of production, water discharge, prevention of waste and other matters. Prior to commencing drilling activities for a well, the Company must procure permits and/or approvals for the various stages of the drilling process from the applicable state and local agencies in the state in which the area to be drilled is located. The permits and approvals include those for the drilling of wells, and the regulation includes maintaining bonding requirements in order to drill or operate wells and regulating the location of wells, the method of drilling and casing wells, the surface use and restoration of properties on which wells are drilled, the plugging and abandoning of wells and the disposal of fluids used in connection with operations. The Company's operations are also subject to various conservation laws and regulations. These include the regulation of the size of drilling and spacing units or proration units and the density of wells which may be drilled and the unitization or pooling of properties. In this regard, some states allow the forced pooling or integration of tracts to facilitate exploration while other states rely primarily or exclusively on voluntary pooling of lands and leases. In areas where pooling is voluntary, it may be more difficult to form units, and therefore, more difficult to develop a project if the operator owns less than 100% of the leasehold. In addition, state conservation laws may establish maximum rates of production from oil and natural gas wells, generally prohibiting the venting or flaring of natural gas and imposing certain requirements regarding the ratability of production. Where wells are to be drilled on state or federal leases, additional regulations and conditions may apply. The effect of these regulations may limit the amount of oil and natural gas the Company can produce from its wells and may limit the number of wells or the locations at which the Company can drill. Such laws and regulations have increased the costs of planning, designing, drilling, installing, operating and abandoning the Company's oil and gas wells and other facilities. In addition, these laws and regulations, and any others that are passed by the jurisdictions where the Company has production, could limit the total number of wells drilled or the allowable production from successful wells, which could limit its reserves. Inasmuch as such laws and regulations are frequently expanded, amended and reinterpreted, the Company is unable to predict the future cost or impact of complying with such regulations.

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**Regulation of Sales and Transportation of Natural Gas**

Historically, the price of natural gas was subject to limitation by federal legislation. The Natural Gas Wellhead Decontrol Act (the "Decontrol Act") removed, as of January 1, 1993, all remaining federal price controls from natural gas sold in "first sales" on or after that date. The Federal Energy Regulatory Commission ("FERC")'s jurisdiction over natural gas transportation was unaffected by the Decontrol Act. While sales by producers of natural gas and all sales of crude oil, condensate and natural gas liquids can currently be made at market prices, there are a number of proposed bills in the United States Congress to reenact price controls or impose "windfall profits" or similar taxes in the future on oil and gas prices. The passage of one of those bills or similar legislation could have the impact of reducing the price received by the Company for its production, or substantially increasing the tax burden associated with its production operations.

The Company moves gas through pipelines owned by other companies, and sells gas to other companies that also utilize common carrier pipeline facilities. Gas pipeline interstate transmission and storage activities are subject to regulation by the FERC under the Natural Gas Act of 1938 ("NGA") and under the Natural Gas Policy Act of 1978, and, as such, rates and charges for the transportation of natural gas in interstate commerce, accounting, and the extension, enlargement or abandonment of its jurisdictional facilities, among other things, are subject to regulation. Each gas pipeline company holds certificates of public convenience and necessity issued by the FERC authorizing ownership and operation of all pipelines, facilities and properties for which certificates are required under the NGA. Each gas pipeline company is also subject to the Natural Gas Pipeline Safety Act of 1968, as amended, which regulates safety requirements in the design, construction, operation and maintenance of interstate natural gas transmission facilities. FERC Order 2004 "Standards of Conduct for Transmission Providers" governs how interstate pipelines communicate and do business with their energy affiliates. One of the cornerstones of Order 2004 is that interstate pipelines will not operate their pipeline systems to preferentially benefit their energy affiliates.

Each interstate natural gas pipeline company establishes its rates primarily through the FERC's ratemaking process. Key determinants in the ratemaking process are:

- costs of providing service, including depreciation expense;
- allowed rate of return, including the equity component of the capital structure and related income taxes;
- volume throughput assumptions.

The Company's sales of natural gas are affected by the availability, terms and cost of transportation. In the past, FERC has undertaken various initiatives to increase competition within the natural gas industry. As a result of initiatives like FERC Order No. 636, issued in April 1992, the interstate natural gas transportation and marketing system was substantially restructured to remove various barriers and practices that historically limited non-pipeline natural gas sellers, including producers, from effectively competing with interstate pipelines for sales to local distribution companies and large industrial and commercial customers. The most significant provisions of Order No. 636 require that interstate pipelines provide transportation separate or "unbundled" from their sales service, and require that pipelines provide firm and interruptible transportation service on an open access basis that is equal for all natural gas suppliers. In many instances, the result of Order No. 636 and related initiatives has been to substantially reduce or eliminate the interstate pipelines' traditional role as wholesalers of natural gas in favor of providing only storage and transportation services. Another effect of regulatory restructuring is the greater transportation access available on interstate pipelines. In some cases, producers and marketers have benefited from this availability. However, competition among suppliers has greatly increased and traditional long-term producer-pipeline contracts are rare. Furthermore, gathering facilities of interstate pipelines are no longer regulated by FERC, thus allowing gatherers to charge higher gathering rates.





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Additional proposals and proceedings that might affect the natural gas industry occur frequently in Congress, FERC, state commissions, state legislatures, and the courts. The natural gas industry historically has been very heavily regulated; therefore, there is no assurance that the less stringent regulatory approach recently pursued by FERC and Congress will continue. The Company cannot determine to what extent future operations and earnings of the Company will be affected by new legislation, new regulations, or changes in existing regulation, at federal, state or local levels.

**Environmental Regulations**

The Company's operations are subject to numerous laws and regulations governing the discharge of materials into the environment or otherwise relating to environmental protection. Public interest in the protection of the environment has increased dramatically in recent years. The trend of more expansive and stricter environmental legislation and regulations could continue. To the extent laws are enacted or other governmental action is taken that restricts drilling or imposes environmental protection requirements that result in increased costs and reduced access to the natural gas industry in general, the business and prospects of the Company could be adversely affected.

The Company generates wastes that may be subject to the Federal Resource Conservation and Recovery Act ("RCRA") and comparable state statutes. The U.S. Environmental Protection Agency ("EPA") and various state agencies have limited the approved methods of disposal for certain hazardous and non-hazardous wastes. Furthermore, certain wastes generated by the Company's operations that are currently exempt from treatment as "hazardous wastes" may in the future be designated as "hazardous wastes," and therefore be subject to more rigorous and costly operating and disposal requirements.

The Company currently owns or leases numerous properties that for many years have been used for the exploration and production of oil and natural gas. Although the Company's management believes that it has utilized good operating and waste disposal practices, prior owners and operators of these properties may not have utilized similar practices, and hydrocarbons or other wastes may have been disposed of or released on or under the properties owned or leased by the Company or on or under locations where such wastes have been taken for disposal. These properties and the wastes disposed thereon may be subject to the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), RCRA and analogous state laws as well as state laws governing the management of oil and natural gas wastes. Under such laws, the Company could be required to remove or remediate previously disposed wastes (including wastes disposed of or released by prior owners or operators) or property contamination (including groundwater contamination) or to perform remedial plugging operations to prevent future contamination.

CERCLA and similar state laws impose liability, without regard to fault or the legality of the original conduct, on certain classes of persons that are considered to have contributed to the release of a "hazardous substance" into the environment. These persons include the owner or operator of the disposal site or sites where the release occurred and companies that disposed of or arranged for the disposal of the hazardous substances found at the site. Persons who are or were responsible for release of hazardous substances under CERCLA may be subject to joint and several liability for the costs of cleaning up the hazardous substances that have been released into the environment and for damages to natural resources, and it is not uncommon for neighboring landowners and other third parties to file claims for personal injury and property damage allegedly caused by the hazardous substances released into the environment.

The Company's operations may be subject to the Clean Air Act ("CAA") and comparable state and local requirements. Amendments to the CAA were adopted in 1990 and contain provisions that may result in the gradual imposition of certain pollution control requirements with respect to air emissions from the operations of the Company. The EPA and states have been developing regulations to implement these requirements. The Company may be required to incur certain capital expenditures in the next several years for air pollution control equipment in connection with maintaining or obtaining operating permits and approvals addressing other air emission-related issues.

The Company's expenses relating to preserving the environment during 2006 were not significant in relation to operating costs and the Company expects no material change in 2007. Environmental regulations have had no materially adverse effect on the Company's operations to date, but no assurance can be given that environmental regulations will not, in the future, result in a curtailment of production or otherwise have a materially adverse effect on the Company's business, financial condition or results of operations.

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**Operating Hazards and Insurance**

The Company's exploration and production operations include a variety of operating risks, including the risk of fire, explosions, blowouts, cratering, pipe failure, casing collapse, abnormally pressured formations, and environmental hazards such as gas leaks, ruptures and discharges of toxic gas, the occurrence of any of which could result in substantial losses to the Company due to injury and loss of life, severe damage to and destruction of property, natural resources and equipment, pollution and other environmental damage, clean-up responsibilities, regulatory investigation and penalties and suspension of operations. The Company's pipeline, gathering and distribution operations are subject to the many hazards inherent in the natural gas industry. These hazards include damage to wells, pipelines and other related equipment, and surrounding properties caused by hurricanes, floods, fires and other acts of God, inadvertent damage from construction equipment, leakage of natural gas and other hydrocarbons, fires and explosions and other hazards that could also result in personal injury and loss of life, pollution and suspension of operations.

Any significant problems related to its facilities could adversely affect the Company's ability to conduct its operations. In accordance with customary industry practice, the Company maintains insurance against some, but not all, potential risks; however, there can be no assurance that such insurance will be adequate to cover any losses or exposure for liability. The occurrence of a significant event not fully insured against could materially adversely affect the Company's operations and financial condition. The Company cannot predict whether insurance will continue to be available at premium levels that justify its purchase or whether insurance will be available at all.

**Competition**

The Company's management believes that its exploration, drilling and production capabilities and the experience of its management and professional staff generally enable it to compete effectively. The Company encounters competition from numerous other oil and natural gas companies, drilling and income programs and partnerships in all areas of its operations, including drilling and marketing oil and natural gas and obtaining desirable oil and natural gas leases and producing properties. Many of these competitors possess larger staffs and greater financial resources than the Company, which may enable them to identify and acquire desirable producing properties and drilling prospects more economically. The Company's ability to explore for oil and natural gas prospects and to acquire additional properties in the future depends upon its ability to conduct its operations, to evaluate and select suitable properties and to consummate transactions in this highly competitive environment. The Company competes with a number of other companies that offer interests in drilling partnerships with a wide range of investment objectives and program structures. Competition for investment capital for both public and private drilling programs is intense. The Company also faces intense competition in the marketing of natural gas from competitors including other producers as well as marketing companies. Also, international developments and the possible improved economics of domestic natural gas exploration may influence other companies to increase their domestic oil and natural gas exploration. Furthermore, competition among companies for favorable prospects can be expected to continue, and it is anticipated that the cost of acquiring properties may increase in the future. During 2006, the industry experienced continued strong demand for drilling services and supplies. This is resulting in increasing costs, and in some cases the demand for supplies and services exceeds the available supplies. This can result in higher well costs and delays in the execution of planned drilling operations. Factors affecting competition in the oil and natural gas industry include price, location of drilling, availability of drilling prospects and drilling rigs, pipeline capacity, quality of production and volumes produced. The Company's management believes that it can compete effectively in the oil and natural gas industry on each of the foregoing factors. Nevertheless, the Company's business, financial condition or results of operations could be materially adversely affected by competition.

**Employees**

As of December 31, 2006, the Company had 189 employees, including 104 in production and seven in natural gas marketing, 32 in exploration and development, 31 in finance, accounting and data processing, and 15 in administration. The Company's engineers, supervisors and well tenders are responsible for the day-to-day operation of wells and pipeline systems. In addition, the Company retains subcontractors to perform drilling, fracturing, logging, and pipeline construction functions at drilling sites, with the Company's employees supervising the activities of the subcontractors. In 2006, the total number of Company employees increased by 39.

The Company's employees are not covered by a collective bargaining agreement. The Company considers relations with its employees to be excellent.

#### **ITEM 1A. RISK FACTORS**

You should carefully consider the following risk factors in addition to the other information included in this report. Each of these risk factors could adversely affect the Company's business, operating results and financial condition, as well as adversely affect the value of an investment in its common stock or other securities.

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*Oil and natural gas prices fluctuate unpredictably and a decline in oil and natural gas prices can significantly affect the Company's financial results and impede its growth.*

The Company's revenue, profitability and cash flow depend in large part upon the prices and demand for oil and natural gas. The markets for these commodities are very volatile and even relatively modest drops in prices can significantly affect the Company's financial results and impede its growth. Changes in oil and natural gas prices have a significant impact on the value of the Company's reserves and on its cash flow. Prices for oil and natural gas may fluctuate widely in response to relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and a variety of additional factors that are beyond the Company's control, including national and international economic and political factors and federal and state legislation.

The prices of oil and natural gas are quite volatile, often fluctuating greatly. Lower oil and natural gas prices may not only reduce the Company's revenues, but also may reduce the amount of oil and natural gas that the Company can produce economically. This may result in the Company having to make substantial downward adjustments to its estimated proved reserves. If this occurs or if the Company's estimates of development costs increase, production data factors change or the Company's exploration results deteriorate, accounting rules may require the Company to write-down operating assets to fair value, as a non-cash charge to earnings. The Company assesses impairment of capitalized costs of proved oil and gas properties by comparing net capitalized costs to estimated undiscounted future net cash flows on a field-by-field basis using estimated production based upon prices at which management reasonably estimates such products to be sold. The Company may incur impairment charges in the future, which could have a material adverse effect on its results of operations.

*The Company's estimated oil and gas reserves are based on many assumptions that may turn out to be inaccurate. Any material inaccuracies in these reserve estimates or underlying assumptions may materially affect the quantities and present value of the Company's reserves.*

No one can measure underground accumulations of oil and natural gas in an exact way. Oil and natural gas reserve engineering requires subjective estimates of underground accumulations of oil and natural gas and assumptions concerning future oil and natural gas prices, production levels, and operating and development costs over the economic life of the properties. As a result, estimated quantities of proved reserves and projections of future production rates and the timing of development expenditures may be inaccurate. The Company's estimates of oil and gas reserves are prepared by independent petroleum engineers, using pricing, production, cost, tax and other information provided by the Company. The reserve estimates are based on certain assumptions regarding future oil and natural gas prices, production levels, and operating and development costs that may prove incorrect. Any significant variance from these assumptions to actual figures could greatly affect the estimates of reserves, the economically recoverable quantities of oil and natural gas attributable to any particular group of properties, future depreciation, depletion and amortization rates and amounts, the classifications of reserves based on risk of recovery, and estimates of the future net cash flows. Some of the Company's reserve estimates must be made with limited production history, which renders these reserve estimates less reliable than estimates based on a lengthy production history. Numerous changes over time to the assumptions on which the reserve estimates are based, as described above, often result in the actual quantities of oil and gas recovered being different from earlier reserve estimates.

The present value of estimated future net cash flows from proved reserves is not necessarily the same as the current market value of the estimated oil and natural gas reserves (the Securities and Exchange Commission requires the use of year end prices). The estimated discounted future net cash flows from proved reserves are based on selling prices in effect on the day of estimate (year end) and future estimated costs. However, actual future net cash flows from the Company's oil and natural gas properties also will be affected by factors such as actual prices it receives for oil and natural gas and hedging instruments, the amount and timing of actual production, amount and timing of future development costs, supply of and demand for oil and natural gas, and changes in governmental regulations or taxation.

The timing of both the Company's production and incurrence of expenses in connection with the development and production of oil and natural gas properties will affect the timing of actual future net cash flows from proved reserves, and thus their actual present value. In addition, the 10% discount factor (the rate required by the Securities and Exchange Commission) the Company uses when calculating discounted future net cash flows may not be the most appropriate discount factor based on interest rates currently in effect and risks associated with its oil and gas properties or the oil and natural gas industry in general.

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*Unless oil and natural gas reserves are replaced as they are produced, the Company's reserves and production will decline, which would adversely affect the Company's future business, financial condition and results of operations.*

Producing oil and natural gas reservoirs generally are characterized by declining production rates that vary depending upon reservoir characteristics and other factors. The rate of decline will change if production from existing wells declines in a different manner than the Company has estimated and can change due to other circumstances. Thus, the Company's future oil and natural gas reserves and production and, therefore, its cash flow and income are highly dependent on efficiently developing and exploiting the Company's current reserves and economically finding or acquiring additional recoverable reserves. The Company may not be able to develop, discover or acquire additional reserves to replace its current and future production at acceptable costs. As a result, the Company's future operations, financial condition and results of operations would be adversely affected.

*Prospects drilled by the Company may not yield natural gas or oil in commercially viable quantities.*

A prospect is a property on which the Company's geologists have identified what they believe, based on available information, to be indications of natural gas or oil bearing rocks. However, the use of available data and other technologies and the study of producing fields in the same area will not enable the geologists to know conclusively prior to drilling and testing whether natural gas or oil will be present or, if present, whether natural gas or oil will be present in sufficient quantities to repay drilling or completion costs and generate a profit. If a well is determined to be dry or uneconomic, which can occur even though it contains some oil or gas, it is classified as a dry hole and must be plugged and abandoned in accordance with applicable regulations. This generally results in the loss of the entire cost of drilling and completion to that point, the cost of plugging, and lease costs associated with the prospect. Even wells that are completed and placed into production may not produce sufficient oil and gas to be profitable. If the Company drills a dry hole or non-profitable well on current and future prospects, the profitability of its operations will decline and the value of the Company will likely be reduced. In sum, the cost of drilling, completing and operating any well is often uncertain and new wells may not be productive.

*The Company may not be able to identify enough attractive prospects on a timely basis to meet its own development needs and those of the partnerships it forms for investors, which could limit the Company's development opportunities and/or force it to reduce partnership activity.*

The Company's geologists have identified a number of potential drilling locations on existing acreage. These drilling locations must be replaced as they are drilled for the Company to continue to grow its reserves and production, and for it to be able to continue its partnership drilling activities. The Company's ability to identify and acquire new drilling locations depends on a number of uncertainties, including the availability of capital, regulatory approvals, oil and natural gas prices, competition, costs, availability of drilling rigs, drilling results and the ability of the Company's geologists to successfully identify potentially successful new areas to develop. Because of these uncertainties, the Company's profitability and growth opportunities may be limited by the timely availability of new drilling locations, and it could be forced to terminate or curtail its partnership activities because of a lack of suitable prospects for the partnerships. As a result, the Company's operations and profitability could be adversely affected.

*Drilling for and producing oil and natural gas are high risk activities with many uncertainties that could adversely affect the Company's business, financial condition and results of operations.*

Drilling activities are subject to many risks, including the risk that the Company will not discover commercially productive reservoirs. Drilling for oil and natural gas can be unprofitable, not only from dry holes, but from productive wells that do not produce sufficient revenues to return a profit. In addition, drilling and producing operations may be curtailed, delayed or canceled as a result of other factors, including unusual or unexpected geological formations, pressures, fires, blowouts, loss of drilling fluid circulation, title problems, facility or equipment



malfunctions, unexpected operational events, shortages or delivery delays of equipment and services, compliance with environmental and other governmental requirements, and adverse weather conditions.

Any of these risks can cause substantial losses, including personal injury or loss of life, damage to or destruction of property, natural resources and equipment, pollution, environmental contamination or loss of wells and regulatory penalties. The Company maintains insurance against various losses and liabilities arising from operations; however, insurance against all operational risks is not available. Additionally, the Company management may elect not to obtain insurance if the cost of available insurance is excessive relative to the perceived risks presented. Thus, losses could occur for uninsurable or uninsured risks or in amounts in excess of existing insurance coverage. The occurrence of an event that is not fully covered by insurance could have a material adverse impact on the Company's business activities, financial condition and results of operations.

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*Increased drilling activity, particularly in the Rocky Mountain Region, may create a shortage of drilling rigs, service providers, or materials, forcing the Company to curtail its drilling operations for itself and its partnerships thereby reducing revenue and profits from new oil and gas wells and from the Company's drilling and completion activities.*

With high levels of oil and gas prices, many oil and gas companies have increased their levels of drilling and completing new wells and reworking old wells. At the same time there is a limited supply of drilling rigs, completion equipment and qualified personnel to provide the services necessary to drill, complete and rework new wells. In particular, the Rocky Mountain Region has seen a great increase in activity over the past few years. If the demand for these goods and services continues to increase, shortages may develop, which could result in increased prices for these goods and services or the Company's inability to complete all of the drilling it has planned. This could result in less drilling by the Company and the temporary or permanent loss of part or all of its partnership drilling activity and less profitability for the Company.

*The Company's drilling and development segment receives virtually all of its revenue from the partnerships it sponsors, and a reduction or loss of that business could reduce or eliminate the revenue and profits associated with those activities.*

The Company's drilling margins associated with its limited partnership programs are dependent upon the capital raised by the Company as a sponsor of limited partnerships. The Company sells oil and natural gas partnerships through a network of non-affiliated NASD broker dealers. The largest of those broker dealers sold about 11% of the partnership units in 2006. Investors in the partnerships benefit from the tax deductions generated by the intangible drilling costs and the cash flow generated by the partnerships. If the tax laws were changed to reduce or eliminate the tax advantages, if the cash flow from the partnerships were to decline due to poor performing wells or lower energy prices, or if the brokers decide to stop offering the Company's partnerships for some reason, the sales of the partnership units would decline, reducing or eliminating the revenue and profits associated with the drilling and development business segment. As a result, the Company's operations and profitability would be adversely affected.

*Under the Successful Efforts accounting method used by the Company unsuccessful exploratory wells must be expensed in the period when they are determined to be non-productive which results in a reduction of the Company's net income and profitability and could have a negative impact on the Company's stock price.*

The Company conducted exploratory drilling in 2006 and plans to continue exploratory drilling in 2007 in order to identify additional opportunities for future development. Under the "successful efforts" method of accounting used by the Company, the cost of unsuccessful exploratory wells must be charged to expense in the period when they are determined to be unsuccessful. In addition lease costs for acreage condemned by the unsuccessful well must also be expensed. In contrast, unsuccessful development wells are capitalized as a part of the investment in the field where they are located. Because exploratory wells generally are more likely to be unsuccessful than development wells, the Company anticipates that some or all of its exploratory wells may not be productive. The costs of such unsuccessful exploratory wells could result in a significant reduction in the Company's profitability in periods when the costs are required to be expensed.

*The Company may incur substantial impairment write-down, if the price of oil and natural gas declines or due to revisions in its estimates of its reserves.*

If oil and natural gas prices decline, if development costs exceed previous estimates, or if management's estimate of the recoverable reserves on a property is revised downward, the Company may be required to record additional non-cash impairment write-downs in the future, which would result in a negative impact to its financial position. The Company reviews its proved oil and gas properties for impairment on a quarterly basis. To determine if a depletable unit is impaired, the Company compares the carrying value of the depletable unit to the undiscounted future net cash

flows by applying management's estimates of future oil and gas prices to the estimated future production of oil and gas reserves over the economic life of the property. Future net cash flows are based upon the Company's independent reserve engineers' estimates of proved reserves. In addition, other factors such as probable and possible reserves are taken into consideration when justified by economic conditions. For each property determined to be impaired, the Company recognizes an impairment loss equal to the difference between the estimated fair value and the carrying value of the property on a depletable unit basis. Fair value is estimated to be the present value of the aforementioned expected future net cash flows. Any impairment charge incurred is recorded as a reduction to the asset value. This calculation is subject to a large degree of judgment, including the determination of the future depletable units, future cash flows and fair value. In 2006, the Company recorded an impairment charge of \$1.5 million related to its Nesson Field in North Dakota. There were no impairments during 2005 or 2004.

*Rising finding and development costs may impair the Company's profitability.*

In order to continue to grow and maintain its profitability, the Company must annually add new reserves exceeding its yearly production at a finding and development cost that yields an acceptable operating margin and depreciation, depletion and amortization rate. Without cost effective exploration, development or acquisition activities, production, reserves and profitability will decline over time. Given the relative maturity of most gas basins in North America and the high level of activity in the industry, the cost of finding new reserves through exploration and development operations has been increasing. The acquisition market for natural gas properties has become extremely competitive among producers for additional production and expanded drilling opportunities in North America. Acquisition values climbed toward historic highs during 2006 on a per unit basis, particularly in the Rocky Mountain Region, and the Company believes these values may continue to increase in 2007. This increase in finding and development costs is resulting in higher depreciation, depletion and amortization rates. If the upward trend in finding and development costs continues, the Company will be exposed to an increased likelihood of a write-down in carrying value of its natural gas and oil properties in response to falling prices and reduced profitability of operations.

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*The Company's development and exploration operations require substantial capital and it may be unable to obtain needed capital or financing on satisfactory terms, which could lead to a loss of properties and a decline in natural gas and oil reserves and production.*

The oil and natural gas industry is capital intensive. The Company makes and expects to continue to make substantial capital expenditures in its business and operations for the exploration for and development, production and acquisition of oil and natural gas reserves. The Company finances capital expenditures primarily with cash generated by operations and proceeds from bank borrowings. Cash flows from operations and access to capital are subject to a number of variables, including the Company's proved reserves, the level of oil and natural gas the Company is able to produce from existing wells, the prices at which oil and natural gas are sold, and the Company's ability to acquire, locate and produce new reserves.

If the Company's revenues or the borrowing base under its revolving credit facility decrease as a result of lower oil and natural gas prices, or it incurs operating difficulties, declines in reserves or for any other reason, it may have limited ability to obtain the capital necessary to sustain its operations at planned levels.

If additional capital is needed, the Company may not be able to obtain debt or equity financing on favorable terms, or at all. If cash generated by operations or sale of limited partnerships or available under the revolving credit facility is not sufficient to meet the capital requirements, failure to obtain additional financing could result in a curtailment of the exploration and development of the Company's prospects, which in turn could lead to a possible loss of properties and a decline in its natural gas and oil reserves and a decline in its profitability.

*The Company's credit facility and other debt financing have substantial restrictions and financial covenants and the Company may have difficulty obtaining additional credit, which could adversely affect its operations.*

The Company depends on its revolving credit facility for future capital needs. The terms of the borrowing agreement require the Company to comply with certain financial covenants and ratios. The Company's ability to comply with these restrictions and covenants in the future is uncertain and will be affected by the levels of cash flows from operations and events or circumstances beyond its control. The Company's failure to comply with any of the restrictions and covenants under the revolving credit facility or other debt financing could result in a default under those facilities, which could cause all of its existing indebtedness to be immediately due and payable.

The revolving credit facility limits the amounts the Company can borrow to a borrowing base amount, determined by the lenders in their sole discretion, based upon projected revenues from the oil and natural gas properties securing its loan. The lenders can unilaterally adjust the borrowing base and the borrowings permitted to be outstanding under the revolving credit facility. Outstanding borrowings in excess of the borrowing base must be repaid immediately, or the Company must pledge other oil and natural gas properties as additional collateral. The Company does not currently have any substantial unpledged properties, and it may not have the financial resources in the future to make any mandatory principal prepayments required under the revolving credit facility. The Company's inability to borrow additional funds under its credit facility could adversely affect its operations.

*A substantial part of the Company's oil and gas production is located in the Rocky Mountains, making it vulnerable to risks associated with operating in one major geographic area.*

The Company's operations are becoming increasingly focused on the Rocky Mountain Region, which means its producing properties and new drilling opportunities are geographically concentrated in that area. As a result, the Company, the success of its operations, and its profitability may be disproportionately exposed to the impact of delays or interruptions of production from existing or planned new wells by significant governmental regulation, transportation capacity constraints, curtailment of production, interruption of transportation, or fluctuations in prices

of oil and natural gas produced from the wells in the region.

*Seasonal weather conditions and lease stipulations adversely affect the Company's ability to conduct drilling activities in some of the areas where it operates.*

Oil and natural gas operations in the Rocky Mountains are adversely affected by seasonal weather conditions and lease stipulations designed to protect various wildlife. In certain areas, including parts of the Piceance Basin in Colorado, drilling and other oil and natural gas activities are restricted or prohibited by lease stipulations, or prevented by weather conditions, for up to six months out of the year. This limits operations in those areas and can intensify competition during those months for drilling rigs, oil field equipment, services, supplies and qualified personnel, which may lead to periodic shortages. These constraints and the resulting shortages or high costs could delay operations and materially increase operating and capital costs and therefore adversely affect profitability.

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*Properties that the Company buys may not produce as projected and the Company may be unable to determine reserve potential, identify liabilities associated with the properties or obtain protection from sellers against those liabilities.*

One of the Company's growth strategies is to acquire producing oil and natural gas reserves in its current areas of operations and in new areas. However, reviews of potential acquisitions are inherently incomplete because it generally is not feasible to review in depth every individual property. Ordinarily, the Company focuses review efforts on the higher value properties and will sample the remainder. However, even a detailed review of records and properties may not necessarily reveal existing or potential problems, nor will it permit a buyer to become sufficiently familiar with the properties to assess fully their deficiencies and potential. Inspections may not always be performed on every well, and environmental problems, such as ground water contamination, are not necessarily observable or detectable even when an inspection is undertaken. Even when problems are identified, the Company may choose to assume certain environmental and other risks and liabilities in connection with acquired properties.

*The Company has limited control over activities on properties it does not operate, which could reduce its production and revenues.*

The Company operates most of the wells in which it owns an interest. However, there are some wells the Company does not operate because it participates through joint operating agreements under which it owns partial interests in oil and natural gas properties operated by other entities. If the Company does not operate the properties in which it owns an interest, it does not have control over normal operating procedures, expenditures or future development of underlying properties. The failure of an operator to adequately perform operations, or an operator's breach of the applicable agreements, could reduce production and revenues and affect the Company's profitability. The success and timing of drilling and development activities on properties operated by others therefore depends upon a number of factors outside of the Company's control, including the operator's timing and amount of capital expenditures, expertise and financial resources, inclusion of other participants in drilling wells, and use of technology.

*Market conditions or operational impediments could hinder access to oil and natural gas markets or delay production.*

Market conditions or the unavailability of satisfactory oil and natural gas transportation arrangements may hinder access to oil and natural gas markets or delay production. The availability of a ready market for oil and natural gas production depends on a number of factors, including the demand for and supply of oil and natural gas and the proximity of reserves to pipelines and terminal facilities. The Company's ability to market its production depends in substantial part on the availability and capacity of gathering systems, pipelines and processing facilities owned and operated by third parties. Failure to obtain such services on acceptable terms could materially harm the Company's business. The Company may be required to shut in wells for lack of market or because of inadequacy, unavailability or the pricing associated with natural gas pipeline, gathering system capacity or processing facilities. If that were to occur, the Company would be unable to realize revenue from those wells until production arrangements were made to deliver the production to market and its profitability would be adversely affected.

*The Company's derivative activities could result in financial losses or could reduce its income.*

To achieve a more predictable cash flow, to reduce exposure to adverse fluctuations in the prices of oil and natural gas and to allow its gas marketing company to offer pricing options to gas sellers and purchasers, the Company uses derivatives for a portion of its oil and natural gas production from its own wells, its partnerships and for gas purchases and sales by its marketing subsidiary. These arrangements expose the Company to the risk of financial loss in some circumstances, including when purchases or sales are different than expected, the counter-party to the derivative contract defaults on its contract obligations, or when there is a change in the expected differential between the

underlying price in the derivative agreement and actual prices received. In addition, derivative arrangements may limit the benefit from changes in the prices for oil and natural gas and may require the use of Company resources to meet cash margin requirements. Since the Company's derivatives do not currently qualify for use of hedge accounting, changes in the fair value of derivatives are recorded in the statements of income and earnings are subject to greater volatility.

*The inability of one or more of the Company's customers to meet their obligations may adversely affect the Company's financial results.*

Substantially all of the Company's accounts receivable result from oil and natural gas sales or joint interest billings to third parties in the energy industry. This concentration of customers and joint interest owners may impact the Company's overall credit risk in that these entities may be similarly affected by changes in economic and other conditions. In addition, the Company's oil and natural gas derivatives as well as the derivatives used by its marketing subsidiary expose the Company to credit risk in the event of nonperformance by counterparties.

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*The Company depends on a limited number of key personnel who would be difficult to replace.*

The Company depends on the performance of its executive officers and other key employees. The loss of any member of senior management or other key employees could negatively impact the Company's ability to execute its strategy.

*Terrorist attacks or similar hostilities may adversely impact the Company's results of operations.*

Increasing terrorist attacks around the world have created many economic and political uncertainties, some of which may materially adversely impact the Company's business. Uncertainty surrounding military strikes or a sustained military campaign may affect the Company's operations in unpredictable ways, including disruptions of fuel supplies and markets, particularly oil, and the possibility that infrastructure facilities, including pipelines, production facilities, processing plants and refineries, could be direct targets of, or indirect casualties of, an act of terror or war. The continuation of these attacks may subject the Company's operations to increased risks and depending on their ultimate magnitude, could have a material adverse effect on its business, results of operations, financial condition and prospects.

*The Company's insurance coverage may not be sufficient to cover some liabilities or losses that the Company may incur.*

The occurrence of a significant accident or other event not fully covered by insurance could have a material adverse effect on the Company's operations and financial condition. Insurance does not protect the Company against all operational risks. The Company does not carry business interruption insurance at levels that would provide enough funds for it to continue operating without access to other funds. For some risks, the Company may not obtain insurance if it believes the cost of available insurance is excessive relative to the risks presented. In addition, pollution and environmental risks generally are not fully insurable.

*The Company may not be able to keep pace with technological developments in its industry.*

The natural gas and oil industry is characterized by rapid and significant technological advancements and introductions of new products and services using new technologies. As others use or develop new technologies, the Company may be placed at a competitive disadvantage, and competitive pressures may force it to implement those new technologies at substantial cost. In addition, other natural gas and oil companies may have greater financial, technical and personnel resources that allow them to enjoy technological advantages and may in the future allow them to implement new technologies before the Company can. The Company may not be able to respond to these competitive pressures and implement new technologies on a timely basis or at an acceptable cost. If one or more of the technologies the Company uses now or in the future were to become obsolete or if it was unable to use the most advanced commercially available technology, its business, financial condition and results of operations could be materially adversely affected.

*Competition in the oil and natural gas industry is intense, which may adversely affect the Company's ability to succeed.*

The oil and natural gas industry is intensely competitive, and the Company competes with other companies that have greater resources. Many of these companies not only explore for and produce oil and natural gas, but also carry on refining operations and market petroleum and other products on a regional, national or worldwide basis. These companies may be able to pay more for productive oil and natural gas properties and exploratory prospects or define, evaluate, bid for and purchase a greater number of properties and prospects than the Company's financial or human resources permit. In addition, these companies may have a greater ability to continue exploration activities during periods of low oil and natural gas market prices. Larger competitors may be able to absorb the burden of present and



future federal, state, local and other laws and regulations more easily than the Company can, which would adversely affect the Company's competitive position. The Company's ability to acquire additional properties and to discover reserves in the future will be dependent upon its ability to evaluate and select suitable properties and to consummate transactions in a highly competitive environment. In addition, because many companies in its industry have greater financial and human resources, the Company may be at a disadvantage in bidding for exploratory prospects and producing oil and natural gas properties. These factors could adversely affect the success of the Company's operations and its profitability.

*The Company is subject to complex federal, state, local and other laws and regulations that could adversely affect the cost, manner or feasibility of doing business.*

The Company's exploration, development, production and marketing operations are regulated extensively at the federal, state and local levels. Environmental and other governmental laws and regulations have increased the costs to plan, design, drill, install, operate and abandon oil and natural gas wells. Under these laws and regulations, the Company could also be liable for personal injuries, property damage and other damages. Failure to comply with these laws and regulations may result in the suspension or termination of operations and subject the Company to administrative, civil and criminal penalties. Moreover, public interest in environmental protection has increased in recent years, and environmental organizations have opposed, with some success, certain drilling projects.

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Part of the regulatory environment includes, in some cases, federal requirements for obtaining environmental assessments, environmental impact studies and/or plans of development before commencing exploration and production activities. In addition, the Company's activities are subject to the regulation by oil and natural gas-producing states of conservation practices and protection of correlative rights. These regulations affect operations and limit the quantity of oil and natural gas that can be produced and sold. A major risk inherent in the Company's drilling plans is the need to obtain drilling permits from state and local authorities. Delays in obtaining regulatory approvals, drilling permits, the failure to obtain a drilling permit for a well or the receipt of a permit with unreasonable conditions or costs could have a material adverse effect on the Company's ability to explore on or develop its properties. Additionally, the oil and natural gas regulatory environment could change in ways that might substantially increase the financial and managerial costs to comply with the requirements of these laws and regulations and, consequently, adversely affect profitability. Furthermore, the Company may be put at a competitive disadvantage to larger companies in the industry who can spread these additional costs over a greater number of wells and larger operating staff. See "Business — Governmental Regulation — Regulation of Oil and Natural Gas Exploration and Production" and "Business — Governmental Regulation — Environmental Regulations" for a description of the laws and regulations that affect us.

*If litigation were commenced against the Company for alleged royalty practices and payments, the cost of our defending the lawsuit could be significant and any resulting judgments against the Company could have a material adverse impact upon our financial condition.*

Recent litigation has commenced against several companies in the Company's industry regarding royalty practices and payments in jurisdictions where the Company conducts business. While the Company's business model differs from those of the litigants in those cases, and the Company has not been named in any litigation, has not had similar litigation commenced, and has not been threatened with such litigation, there can be no assurance that the Company will not become a party to such litigation or to similar litigation in the future. If litigation of this nature were commenced against us, even if the ultimate outcome of the litigation resulted in a judgment for the Company, the cost of defending the Company could be significant. These costs would be reflected in terms of dollar outlay as well as the amount of time, attention and other resources that the Company's management would have to appropriate to the defense. Although the Company cannot predict an eventual outcome were litigation to be commenced against us, a judgment in favor of the plaintiffs could have a material adverse impact upon the Company's financial condition.

*Material weaknesses in the Company's internal control over financial reporting and disclosure controls and procedures could adversely impact the reliability of its internal control over financial reporting, its ability to timely file certain reports with the SEC, the liquidity of the market for its common stock and its ability to raise investment capital to support its drilling operations in the future.*

Management has assessed the effectiveness of internal control over financial reporting as of December 31, 2006, and this assessment identified material weaknesses in internal control over financial reporting and disclosure controls and procedures. For discussion of these material weaknesses and the Company's remediation plans, please see Part II, Item 9A, "Controls and Procedures" of this report. As a result of these material weaknesses, management concluded that the Company's internal control over financial reporting and disclosure controls and procedures were not effective as of December 31, 2006.

Material weaknesses were also identified during management's assessment of the internal control environment as of December 31, 2005. A description of these material weaknesses can be found in Part II, Item 9A, "Controls and Procedures" of the Annual Report for fiscal year 2005. As a result of these material weaknesses, management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2005.

The Company's material weaknesses have led to restatements of its consolidated financial statements in connection with the filing of its annual report on Form 10-K for the year ended December 31, 2005. These material weaknesses have also contributed to the delays the Company has experienced in filing its annual reports on Form 10-K for the years ended December 31, 2006 and 2005. In addition, the Company did not timely file with the SEC its Form 10-Q for the quarters ended March 31, 2007 and 2006. A continued inability to timely file its periodic reports with the SEC could involve a number of significant risks, which could have an adverse impact on the Company's operations, on the market for its stock and investors generally, including:

- The potential delisting of the Company's common stock. The Company's failure to file its periodic reports timely constitutes a violation of the listing standards of the NASDAQ Stock Market. If the NASDAQ Stock Market ceases to grant the Company extensions of time in which to file its reports, NASDAQ has the right to begin proceedings to delist the Company's common stock. The Company had a hearing before the NASDAQ Listing Qualifications Panel ("Panel") on May 10, 2007, regarding the Company's failure to file timely its Form 10-K for the year ended December 31, 2006. The Panel also considered the Company's failure to file timely its Form 10-Q for the period ended March 31, 2007. It is possible that the Panel might order the delisting of the Company's stock from NASDAQ. The delisting of the Company's common stock could have a material adverse effect on the Company by:

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- reducing the liquidity and market price for its common stock;
- reducing the number of investors willing to hold or acquire its common stock, which in turn could further reduce its stock's liquidity; and
- limiting the ability of investors to sell the Company's common stock.

If the Company is unable to prepare and file its annual report on Form 10-K in a timely manner, and to a lesser degree, if the Company is unable to prepare and file one or more of its quarterly reports on Form 10-Q in a timely manner, the Company might be unable to raise capital for Company operations, either by its selling of its securities or through a borrowing facility. In this regard, under those circumstances the Company could be faced with any of the following risks:

- If the Company were unable to file its financial statements because it is unable to file its annual report on Form 10-K and/or its quarterly financial reports on Form 10-Q, the Company would not be able to raise capital from the public markets through the sale of its stock or debt securities through an SEC-registered public offering. Likewise, the Company's inability to file its required periodic reports with the SEC in a timely fashion may hinder its ability to raise capital through the private placement of its securities.
- A major component of the Company's business plan is to raise drilling capital through its public and private sales of partnership interests. If the Company is unable to file its annual reports and/or quarterly reports in a timely fashion, it will not be able to access the public markets through an SEC-registered securities offering; and it may have difficulty in accessing the private placement market for capital through an SEC-exempt securities offering.
- The Company's credit facility with JPMorgan Chase and BNP Paribas ("Lenders") requires the Company to be current in its filing of its required periodic reports with the SEC. If the Company is unable to file its annual reports and/or quarterly reports with the SEC when due, the Lenders might declare the credit facility to be in default and any loans then outstanding under the credit facility would be immediately due and payable. Additionally, even if the Lenders did not declare a default and accelerate repayment of outstanding amounts, the Company might not be able to borrow further amounts under the facility. Moreover, the Company under those circumstances might not be able to negotiate and arrange alternative financing to support its drilling operations. See Note 5 to consolidated financial statements for discussion related to the current waiver the Company has received under the credit facility.

If the Company is unable to raise drilling capital and funding for its operations as cited in the three preceding paragraphs, then it would be likely that its drilling operations would be materially adversely affected; and that its ability to grow the Company in the historical manner would be severely hampered. Moreover, it is likely that the Company's business operations could be materially adversely damaged.

- Currently, the Company has several employee and director stock benefit plans in which its common stock available under the plans has been registered by SEC Form S-8 under the Securities Act of 1933. Under SEC regulations, the Company's failure to file with the SEC required annual reports on Form 10-K will cause its Form S-8 registration statement to be stale - that is, not current as to information about the Company. The result is that the Form S-8 would no longer be in compliance with the requirements of the Securities Act, compliance with which allowed the Company to offer these stock benefits to Company employees for their investment. Consequently, if the Company does not file its annual reports with the SEC in a timely fashion, the Company will have to suspend the availability of these plans, including the Company's 401(k) and Profit Sharing Plan, to allow Company employees to exercise any Company stock options that they hold or to choose to invest in Company common stock under the 401(k) and Profit Sharing Plan. Additionally, those Company employees who own shares of the Company's common stock might find it more difficult to sell their shares in the market if the Company's common stock is delisted from the NASDAQ Stock Market.

Furthermore, the number of subsequent failures to timely file any future periodic reports with the SEC could increase the likelihood, frequency of occurrence, and severity of the impact of any of the risks described above.

Since the identification of these material weaknesses, the Company has implemented and is continuing to implement various procedures intended to improve its internal control over financial reporting and disclosure controls and procedures. No assurance can be given that the Company will be effective in remedying all identified deficiencies in its internal control over financial reporting and disclosure controls and procedures. The Company has implemented procedures to remediate the material weaknesses identified during fiscal year 2005, and while management believes that the reconciliation, capitalization assessment, valuation, completeness determination and monitoring procedures and controls implemented since December 31, 2006, will, when demonstrated to be operating effectively, allow management to conclude that the material weaknesses identified in 2006 have been remediated, there can also be no assurance that the material weaknesses will be rectified in a timely fashion or that additional material weaknesses will not arise and be identified.

Index**ITEM 1B. UNRESOLVED STAFF COMMENTS**

In September 2006, the Company received written comments from the staff of the SEC regarding its Annual Report on Form 10-K for the year ended December 31, 2005 ("2005 Form 10-K"), to which the Company has subsequently provided responses. The staff have since indicated to the Company that they have no further outstanding comments related to the Company's 2005 Form 10-K. As a result, the Company does not believe it has any currently outstanding comments with the staff with regard to its own filings.

However, the Company, as managing general partner, has not yet filed all Company-sponsored partnerships' 2005 Forms 10-K, related to which the Company has previously issued filings on Forms 8-K (dated August 25, 2005, and November 15, 2005) advising that, due to errors in its accounting policies and practices, no reliance should be placed on the related financial information, nor on the auditors' opinion related thereto. As of the date of this filing, the Company has not completed the corrections of these errors and is delinquent in its filing requirements for 24 such Company-sponsored partnerships with regard to the year ended December 31, 2005. Additionally, for each of the same Company-sponsored partnerships, the Company has not filed related Forms 10-Q for the quarterly periods ended March 31, 2006, June 30, 2006, September 30, 2006, and March 31, 2007, or Forms 10-K for the year ended December 31, 2006.

**ITEM 2. PROPERTIES**

## Summary of Productive Wells

The table below shows the number of the Company's productive gross and net wells at December 31, 2006.

Location	Productive Wells			
	Gas		Oil	
	Gross	Net	Gross	Net
Colorado	1,445	794.0	25	19.3
Kansas	40	39.0	-	-
Michigan	199	106.0	7	2.7
North				
Dakota	5	1.1	12	6.2
Pennsylvania	420	93.1	-	-
Tennessee	1	0.7	35	13.7
West				
Virginia	905	515.9	4	1.7
Wyoming	-	-	3	0.7
Total	3,015	1,549.8	86	44.3

**Oil and Gas Reserves**

All of the Company's natural gas and oil reserves are located in the United States. The Company's approximate net proved reserves were estimated by independent petroleum engineers, to be 279,078 MMcf of natural gas and 7,272 MBbls of oil at December 31, 2006, 247,288 MMcf of natural gas and 4,538 MBbls of oil at December 31, 2005, and 197,549 MMcf of natural gas and 3,316 MBbls of oil at December 31, 2004.

The Company's approximate net proved developed reserves were estimated, by independent petroleum engineers, to be 158,978 MMcf of natural gas and 4,629 MBbls of oil at December 31, 2006, 155,354 MMcf of natural gas and 3,860 MBbls of oil at December 31, 2005, and 146,152 MMcf of natural gas and 3,190 MBbls of oil at December 31,

2004.

The Company utilized the services of two independent petroleum engineers for its 2006 independent reserve report. Wright & Company prepared the reserve report for the Appalachian and Michigan Basin and Northeast Colorado ("NECO") properties. Ryder Scott Company, LLP prepared the reserve report for the Rocky Mountain Region, with the exception of the NECO properties. Wright & Company prepared all of the reserve reports for the Company for 2005 and 2004 with the exception of 2005 North Dakota wells which were prepared by Ryder Scott Company.

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The Company's oil and natural gas reserves by region are as follows as of December 31, 2006:

	Oil (MBbl)	Gas (MMcf)	Natural Gas Equivalent (MMcfe)	%
<u>Proved Developed Reserves</u>				
Appalachian Basin	29	35,840	36,014	19.3%
Michigan Basin	36	20,331	20,547	11.0%
Rocky Mountain Region	4,564	102,807	130,191	69.7%
Total Proved Developed Reserves	4,629	158,978	186,752	100.0%
<u>Proved Undeveloped Reserves</u>				
Appalachian Basin	-	-	-	0.0%
Michigan Basin	-	685	685	0.5%
Rocky Mountain Region	2,643	119,415	135,273	99.5%
Total Proved Undeveloped	2,643	120,100	135,958	100.0%
<u>Total Proved Reserves</u>				
Appalachian Basin	29	35,840	36,014	11.2%
Michigan Basin	36	21,016	21,232	6.6%
Rocky Mountain Region	7,207	222,222	265,464	82.2%
Total Proved Reserves	7,272	279,078	322,710	100.0%

No major discovery or other favorable or adverse event that would cause a significant change in estimated reserves on the properties owned by the Company as of December 31, 2006, is believed by the Company to have occurred since December 31, 2006, with the exception of the following acquisitions:

- In January 2007, the Company acquired 144 oil and gas wells and 8,160 acres of leasehold in the Wattenberg Field area of the DJ Basin, Colorado and an increased net interest in 718 wells currently operated by the Company.
- In February 2007, the Company acquired 28 producing wells and associated undeveloped acreage in the Wattenberg Field.

Reserves cannot be measured exactly, because reserve estimates involve subjective judgment. The estimates must be reviewed periodically and adjusted to reflect additional information gained from reservoir performance, new geological and geophysical data and economic changes.

The standardized measure of discounted future estimated net cash flows attributable to the Company's proved oil and gas reserves, giving effect to future estimated income tax expenses, was estimated by the Company's independent petroleum engineers to be \$215.7 million as of December 31, 2006, \$405.4 million as of December 31, 2005, and \$229.4 million as of December 31, 2004. These amounts are based on December 31 commodity prices in the respective years. The values expressed are estimates only, and may not reflect realizable values or fair market values of the natural gas and oil ultimately extracted and recovered. The standardized measure of discounted future net cash flows may not accurately reflect proceeds of production to be received in the future from the sale of natural gas and oil currently owned and does not necessarily reflect the actual costs that would be incurred to acquire equivalent natural gas and oil reserves.

**Net Proved Natural Gas and Oil Reserves**



The proved reserves of natural gas and oil of the Company as estimated by the Company's independent petroleum engineers at December 31, 2006, are set forth below. These reserves have been prepared in compliance with the rules of the SEC based on December 31, 2006, prices. These reserve estimates were not filed with another Federal authority or agency since the Company filed its Form 10-K with the SEC on May 31, 2006, for the year ended December 31, 2005. An analysis of the change in estimated quantities of natural gas and oil reserves from January 1, 2006 to December 31, 2006, all of which are located within the United States, is shown below:

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	Natural Gas (MMcf)	Oil (MBbl)
Proved developed and undeveloped reserves:		
Beginning of year	247,288	4,538
Revisions of previous estimates	(28,067)	35
Beginning of year as revised	219,221	4,573
New discoveries and extensions		
Rocky Mountain region	70,499	3,148
Dispositions to partnerships	(1,215)	(92)
Acquisitions		
Michigan basin	35	-
Rocky Mountain region	3,477	274
Appalachian basin	222	-
Production	(13,161)	(631)
End of year	279,078	7,272
Proved developed reserves:		
Beginning of year	155,354	3,860
End of year	158,978	4,629

### Standardized Measure of Discounted Future Net Cash Flows and Changes Therein Relating to Proved Natural Gas and Oil Reserves

Summarized in the following table is information for the Company with respect to the standardized measure of discounted future net cash flows relating to proved natural gas and oil reserves at December 31, 2006. Future cash inflows are computed by applying year-end prices of natural gas and oil relating to the Company's proved reserves to year-end quantities of those reserves. Future production, development, site restoration and abandonment costs are derived based on current costs, assuming continuation of existing economic conditions. Future income tax expenses are computed by applying the statutory rate in effect at December 31, 2006, to the future pretax net cash flows, less the tax basis of the properties, and gives effect to permanent differences, tax credits and allowances related to the properties. (in thousands)

Future estimated cash flows	\$ 1,804,796
Future estimated production costs	(571,346)
Future estimated development costs	(373,460)
Future estimated income tax expense	(334,536)
Future net cash flows	525,454
10% annual discount for estimated timing of cash flows	(309,792)
Standardized measure of discounted future estimated net cash flows	\$ 215,662

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The following table summarizes the principal sources of change in the standardized measure of discounted future estimated net cash flows from January 1, 2006, through December 31, 2006: (in thousands)

Sales of oil and gas production net of production costs	\$ (94,337)
Net changes in prices and production costs	(299,721)
Extensions, discoveries, and improved recovery, less related costs	46,109
Sales of reserves	(3,356)
Purchase of reserves	11,003
Development costs incurred during the period	20,051
Revisions of previous quantity estimates	(23,146)
Changes in estimated income taxes	120,818
Accretion of discount	62,838
Timing and other	(30,027)
Total	\$ (189,768)

It is necessary to emphasize that the data presented should not be viewed as representing the expected cash flow from, or current value of, existing proved reserves, because the computations are based on a large number of estimates and assumptions. Reserve quantities cannot be measured with precision, and their estimation requires many judgmental determinations and frequent revisions. The required projection of production and related expenditures over time requires further estimates with respect to pipeline availability, rates of demand and governmental control. Actual future prices and costs are likely to be substantially different from the current prices and costs utilized in the computation of reported amounts. Any analysis or evaluation of the reported amounts should give specific recognition to the computational methods and their inherent limitations.

Substantially all of the Company's natural gas and oil reserves have been mortgaged or pledged as security for the Company's credit agreement. See Note 5 to the notes to the Company's financial statements.

**Oil and Natural Gas Leases**

The following table sets forth the by state leased acres available to the Company for development of oil and natural gas as of December 31, 2006.

Colorado	42,900
Kansas	23,000
Michigan	200
New York	12,800
North Dakota	89,600
Wyoming	32,000
Total	200,500

**Title to Properties**

The Company's management believes that it holds good and indefeasible title to its properties, in accordance with standards generally accepted in the natural gas industry, subject to such exceptions stated in the opinion of counsel

employed in the various areas in which the Company conducts its exploration activities. Those exceptions, in the Company's judgment, do not detract substantially from the use of such property. As is customary in the natural gas industry, only a perfunctory title examination is conducted at the time the properties believed to be suitable for drilling operations are acquired by the Company. Prior to the commencement of drilling operations, a title examination is conducted and curative work is performed with respect to defects which the Company deems to be significant. A title examination has been performed with respect to substantially all of the Company's producing properties. No single property owned by the Company represents a material portion of the Company's holdings.

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The properties owned by the Company are subject to royalty, overriding royalty and other outstanding interests customary in the industry. The properties are also subject to burdens such as liens incident to operating agreements, current taxes, development obligations under natural gas and oil leases, farm-out arrangements and other encumbrances, easements and restrictions. The Company does not believe that any of these burdens will materially interfere with the use of the properties.

**Facilities**

The Company completed the construction of its new corporate headquarters in Bridgeport, West Virginia, which was occupied in December 2006. The Company intends to begin construction of a second office building adjacent to its new corporate headquarters in 2007. The Company's prior Bridgeport offices, consisting of two buildings, will be placed on the market and available for sale sometime in 2007. The Company has an operating lease for its Denver Office in Denver, Colorado.

The Company owns a field operating facility in each of Harrison and Gilmer Counties, West Virginia, Alpena County, Michigan and Weld County, Colorado. The Company has operating leases for two field offices in Colorado and one in Pennsylvania.

**ITEM 3. LEGAL PROCEEDINGS**

From time to time the Company is a party to various legal proceedings in the ordinary course of business. The Company is not currently a party to any litigation that it believes would have a materially adverse affect on the Company's business, financial condition, results of operations, or liquidity.

Recent litigation has commenced against several companies in our industry regarding royalty practices and payments in jurisdictions where the Company conducts business. While the Company's business model differs from those of the litigants in those cases, and the Company has not been named in any litigation, has not had similar litigation commenced, nor has such litigation been threatened, there can be no assurance that the Company will not be a party to any litigation or to similar litigation in the future.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

**PART II**

**ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDERS MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

The authorized capital stock of the Company consists of 50,000,000 shares of common stock, par value \$0.01 per share. There were 14,887,530 shares of common stock issued and outstanding as of April 30, 2007. The common stock of the Company is traded on the NASDAQ Global Select Market under the ticker symbol PETD.

The following table sets forth the range of high and low sales prices for the Company's common stock as reported on the NASDAQ Global Select Market for the periods indicated below.

	High	Low
2006		

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First Quarter	\$	46.06	\$	32.46
Second Quarter		45.07		32.89
Third Quarter		44.54		33.32
Fourth Quarter		46.61		36.96

2005

First Quarter		44.19		35.72
Second Quarter		37.28		22.65
Third Quarter		40.00		32.54
Fourth Quarter		39.55		30.53

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As of April 30, 2007, there were approximately 908 record holders of the Company's common stock.

The Company has not paid any dividends on its common stock and currently intends to retain earnings for use in its business. Therefore, it does not expect to declare cash dividends in the foreseeable future.

## ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 - 20, 2006	334,242	\$ 40.93	334,242	1,477,109
Total	334,242	\$ 40.93	334,242	1,477,109

In January 2006, the Company announced that its Board of Directors had authorized the Company to purchase up to 10% (1,627,500 shares) of its outstanding common stock during 2006. Stock purchases under this program were made in the open market or in private transactions, at times and in amounts that management deemed appropriate. On October 20, 2006, the Company completed its January 2006 share purchase program. Total shares purchased in 2006 pursuant to the program were 1,627,500 common shares at a cost of \$66.3 million (\$40.75 average price paid per share), including 100,000 shares from an executive officer of the Company at a cost of \$4.1 million (\$40.66 price paid per share). All shares purchased in accordance with the program were subsequently retired.

On October 16, 2006, the Board of Directors of the Company approved a second 2006 share purchase program authorizing the Company to purchase up to 10% of the Company's then outstanding common stock (1,477,109 shares) through April 2008. Stock purchases under this program may be made in the open market or in private transactions, at times and in amounts that management deems appropriate. The Company may terminate or limit the stock purchase program at any time.

Index**ITEM 6. SELECTED FINANCIAL DATA (in thousands, except per share data)**

	Year Ended December 31,				
	2006	2005	2004	2003	2002
<b>Revenues:</b>					
Oil and gas well drilling operations	\$ 17,917	\$ 99,963	\$ 94,076	\$ 57,510	\$ 45,842
Gas sales from marketing activities	131,325	121,104	94,627	73,132	43,537
Oil and gas sales	115,189	102,559	69,492	48,394	22,688
Well operations and pipeline income	10,704	8,760	7,677	6,907	5,771
Oil and gas price risk management gains (losses), net	9,147	(9,368)	(3,085)	(812)	(370)
Other income	2,221	2,180	1,696	3,338	2,549
<b>Total revenues</b>	<b>286,503</b>	<b>325,198</b>	<b>264,483</b>	<b>188,469</b>	<b>120,017</b>
<b>Costs and expenses:</b>					
Cost of oil and gas well drilling operations	12,617	88,185	77,696	46,946	37,859
Cost of gas marketing activities	130,150	119,644	92,881	72,361	43,168
Oil and gas production and well operations costs	29,021	20,400	17,713	13,630	8,672
Exploration cost	8,131	11,115	-	-	-
General and administrative expense	19,047	6,960	4,506	4,975	4,392
Depreciation, depletion and amortization	33,735	21,116	18,156	15,313	12,602
<b>Total costs and expenses</b>	<b>232,701</b>	<b>267,420</b>	<b>210,952</b>	<b>153,225</b>	<b>106,693</b>
Gain on sale of leaseholds	328,000	7,669	-	-	-
Income from operations	381,802	65,447	53,531	35,244	13,324
Interest income	8,050	898	185	190	248
Interest expense	(2,443)	(217)	(238)	(816)	(1,505)
Income before income taxes and cumulative effect of change in accounting principle	387,409	66,128	53,478	34,618	12,067
Income taxes	149,637	24,676	20,250	11,934	3,186
Income before cumulative effect of change in accounting principle	237,772	41,452	33,228	22,684	8,881
Cumulative effect of change in accounting principle (net of taxes of \$1,392)	-	-	-	(2,271)	-
<b>Net income</b>	<b>\$ 237,772</b>	<b>\$ 41,452</b>	<b>\$ 33,228</b>	<b>\$ 20,413</b>	<b>\$ 8,881</b>
Basic earnings per common share	\$ 15.18	\$ 2.53	\$ 2.05	\$ 1.30	\$ 0.56



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Diluted earnings per share           \$     **15.11**   \$     2.52   \$     2.00   \$     1.25   \$     0.55

	December 31,				
	2006	2005	2004	2003	2002
Total Assets	\$ <b>884,287</b>	\$ <b>444,361</b>	\$   329,453	\$   294,004	\$   198,838
Working Capital (Deficit)	\$ <b>29,180</b>	\$ <b>(16,763)</b>	\$       231	\$       7,287	\$       2,645
Long-Term Debt	\$ <b>117,000</b>	\$ <b>24,000</b>	\$    21,000	\$    53,000	\$    25,000
Stockholders' Equity	\$ <b>360,144</b>	\$ <b>188,265</b>	\$   154,021	\$   112,559	\$     92,887

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995**

Statements, other than historical facts, contained in this Annual Report on Form 10-K, including statements of estimated oil and gas production and reserves, drilling plans, future cash flows, anticipated capital expenditures and Management's strategies, plans and objectives, are "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Although the Company's management believes that its forward looking statements are based on reasonable assumptions, it cautions that such statements are subject to a wide range of risks and uncertainties incidental to the exploration for, acquisition, development, production and marketing of oil and gas, and it can give no assurance that its estimates and expectations will be realized. 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 the Company's success in discovering, acquiring, developing and producing oil and gas reserves; the Company's ability to acquire leases, drilling rigs, supplies and services at reasonable prices; the availability of capital to the Company; the Company's ability to raise funds through its Partnership Drilling Programs; risks incident to the drilling and operation of oil and gas 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 oil and gas derivatives activities; and conditions in the capital markets. Other risk factors are discussed elsewhere in this Form 10-K.

**Results of Operations**

***Management Overview***

The Company recorded strong revenues and cash flows for 2006. Although average commodity prices declined during 2006 compared to 2005, a record 24% production increase more than compensated for the price decline, as oil and gas sales increased \$12.6 million over 2005. The recent trend in declining profit margins on the Company's oil and gas well drilling operations segment reversed during the latter part of the year, as the Company switched from footage-based drilling contracts, which lead to the declining margins, to cost-plus contracts where the Company does not bear the risk of cost changes on the wells it drills for the partnerships. However, this change in type of contract, which allowed the Company to recognize a contracted rate of profit from oil and gas well drilling operations, resulted in an equal \$74.6 million decline in revenue and related costs. See "Drilling Operations" below for further discussion.

The principal business event of the year was the sale of undeveloped property in the Grand Valley Field in the third quarter for a gain of \$328 million, with approximately \$26 million in additional gains on the transaction deferred to future periods, to be recognized if wells are drilled on certain properties. The proceeds of the sale, the qualification of the sale for like-kind exchange tax status and the property purchased during 2006 and 2007 have substantially strengthened the Company's financial position and positioned it for continuing growth in the coming periods.

**Year Ended December 31, 2006, Compared to December 31, 2005**

***Revenues***

Total revenues for the year ended December 31, 2006, were \$286.5 million compared to \$325.2 million for the year ended December 31, 2005, a decrease of approximately \$38.7 million, or 11.9%. The decrease was primarily attributable to a decrease in drilling revenues of \$82.1 million partially offset by the increased oil and gas sales from both gas marketing activities and the Company's share of production for a total of \$22.9 million and the swing from a

\$9.4 million loss in oil and gas price risk management for the year ended December 31, 2005, to a gain of \$9.1 million for the year ended December 31, 2006. See "Drilling Operations" below for an explanation of the impact the new cost-plus drilling arrangements and related accounting had on drilling revenues for the year 2006.

*Costs and Expenses*

Total costs and expenses for the year ended December 31, 2006, were \$232.7 million compared to \$267.4 million for the year ended December 31, 2005, a decrease of approximately \$34.7 million, or 13%. The decrease was primarily attributable to decreases in the cost of oil and gas well drilling operations of \$75.6 million and exploration cost of \$3 million offset in part by increases in the cost of gas marketing activities of \$10.5 million, oil and gas production and well operations costs of \$8.6 million, general and administrative expenses of \$12.1 million and depreciation, depletion and amortization of \$12.6 million. See "Drilling Operations" below for an explanation of the impact of the new cost plus drilling arrangements and related accounting had on drilling expenses for the year 2006.

Index**Drilling Operations**

During the first quarter of 2006, the Company began operating and recognizing revenues for its cost-plus service arrangements with new partnerships, in addition to its footage-based drilling arrangements on earlier partnerships. The cost-plus drilling arrangements became effective with the private program partnership funded by the Company in December 2005 and continued in the 2006 partnership funded on September 1, 2006. Drilling revenues for the year ended December 31, 2006, were \$17.9 million, net of \$74.6 million of costs related to drilling arrangements accounted for on the cost-plus basis, compared to \$100 million for the year ended December 31, 2005, a decrease of \$82.1 million. The decrease was primarily due to the change in the Company's drilling contracts, which resulted in net revenue recognition related to the new contracts.

The costs of oil and gas well drilling operations for the year ended December 31, 2006, was \$12.6 million compared to \$88.2 million for the year ended December 31, 2005, a decrease of \$75.6 million. The decrease in costs is primarily attributable to the Company's revenue reporting for its new cost-plus drilling arrangements, which reduced drilling costs by \$74.6 million for the year as discussed above.

The new cost-plus drilling arrangement eliminates the Company's risk of loss from the contract drilling services it provides the partnerships. The Company's drilling revenues and corresponding costs are presented net as a one-lined income statement item representing only the gross profit portion of the drilling arrangement. The new cost-plus contract impacted the current year period by reducing drilling revenues and drilling costs by \$74.6 million as outlined in the table below (in millions):

	Year ended December 31, 2006			2005	
	Drilling Service Revenue/Cost	Direct Reimbursed Cost	Revenue/Cost Including reimbursement from Partnerships	Drilling Service Revenue/Cost	
Oil and gas well drilling operations	\$ 17.9	\$ 74.6	\$ 92.5	\$	100.0
Total revenues	\$ 286.5	\$ 74.6	\$ 361.1	\$	325.2
Cost of oil and gas well drilling operations	\$ 12.6	\$ 74.6	\$ 87.2	\$	88.2
Total costs and expenses	\$ 232.7	\$ 74.6	\$ 307.3	\$	267.4

Although the Company changed to cost-plus drilling arrangements with its two recent partnerships, prior footage-based contracts continue to be in effect, and realized a loss of \$2.1 million during 2006. This loss contributed to the decrease in the drilling and development segment gross margin from \$11.8 million for the year ended December 31, 2005, to \$5.3 million for the year ended December 31, 2006. This loss was due to some drilling and completion difficulties incurred and significantly increasing well drilling and completion costs, particularly the costs of fracturing and rising steel costs for casing and other well equipment and oil field services. Future partnerships will be drilled on a "cost-plus basis," which should reduce these fluctuations in drilling gross margins. See Note 1 to the consolidated financial statements.

**Natural Gas Marketing Activities**

Natural gas sales from the marketing activities of RNG, the Company's marketing subsidiary, increased for the year ended December 31, 2006, to \$131.3 million compared to \$121.1 million for the year ended December 31, 2005, an increase of approximately \$10.2 million, or 8.4%. The increase was the result of a 9% increase in volumes sold at prices 17.2% lower than 2005 levels and significant unrealized gains on derivative transactions which amounted to approximately \$12.3 million for the year ended December 31, 2006, compared to unrealized losses of \$8.5 million for the year ended December 31, 2005.

The costs of gas marketing activities for the year ended December 31, 2006, were \$130.2 million compared to \$119.6 million for the year ended December 31, 2005, an increase of \$10.6 million, or 8.9%. The increase was due to higher average volumes of natural gas purchased for resale and a significant increase in unrealized losses on derivative transactions, which amounted to approximately \$11.9 million for the year ended December 31, 2006, compared to an unrealized gain of \$8.3 million for the year ended December 31, 2005. Income before income taxes for the Company's natural gas marketing subsidiary increased from \$1.7 million for the year ended December 31, 2005, to \$1.8 million for the year ended December 31, 2006. Based on the nature of the Company's gas marketing activities, derivatives did not have a significant impact on the Company's net margins from marketing activities during either period.

Index**Oil and Gas Sales**

Oil and gas sales from the Company's producing properties for the year ended December 31, 2006, were \$115.2 million compared to \$102.6 million for the year ended December 31, 2005, an increase of \$12.6 million, or 12.3%. The increase was due to a 24% increase in volumes sold at lower average sales prices of natural gas and, in part, to higher average sales prices and higher volumes sold of oil. The volume of natural gas sold for the year ended December 31, 2006, was 13.2 Bcf at an average price of \$5.91 per Mcf compared to 11.0 Bcf at an average sales price of \$7.29 per Mcf for the year ended December 31, 2005. Oil sales for the year ended December 31, 2006, were 631,000 barrels at an average sales price of \$59.33 per barrel compared to 439,000 barrels at an average sales price of \$50.56 per barrel for the year ended December 31, 2005. The increase in natural gas and oil volumes was the result of the Company's increased investment in oil and gas properties, primarily the increase in net wells drilled for the Company's own account, recompletions of existing wells, and the investment in oil and gas properties it owns in drilling program partnerships.

**Oil and Gas Production**

The Company's oil and gas production by area of operations along with average sales price (excluding derivative gains and losses) is presented below:

	Year Ended December 31, 2006			Year Ended December 31, 2005		
	Oil (Bbl)	Natural Gas (Mcf)	Natural Gas Equivalents (Mcf)*	Oil (Bbl)	Natural Gas (Mcf)	Natural Gas Equivalents (Mcf)*
Appalachian Region	1,837	1,451,729	1,462,751	3,973	1,631,552	1,655,390
Michigan Region	4,439	1,399,852	1,426,486	4,732	1,555,958	1,584,350
Rocky Mountain Region	625,119	10,309,203	14,059,917	430,266	7,843,250	10,424,846
Total	631,395	13,160,784	16,949,154	438,971	11,030,760	13,664,586
Average Sales Price	\$ 59.33	\$ 5.91	\$ 6.80	\$ 50.56	\$ 7.29	\$ 7.51

\*Six Bbl equals one Mcfe

Financial results depend upon many factors, particularly the price of natural gas and the Company's ability to market its production effectively. Natural gas and oil prices have been among the most volatile of all commodity prices. These price variations can have a material impact on the Company's financial results. Natural gas and oil prices also vary by region, and locality, depending upon the distance to markets, and the supply and demand relationships in that region or locality. This can be especially true in the Rocky Mountain Region. The combination of increased drilling activity and the lack of local markets can entail a local oversupply situation from time to time. There are a number of different pipelines in various stages of construction which will help to maintain a balance between supply and demand. However, there may be times in which there may be oversupply situations for short or longer terms, which may affect the amount of gas or oil that the Company can sell, and the price at which it sells gas or oil. Like most other producers in the region, the Company relies on major interstate pipeline companies to construct these facilities, so their timing is not within its control.

**Oil and Gas Derivative Activities**

Because of uncertainty surrounding natural gas prices, the Company has used various derivative instruments to manage some of the impact of fluctuations in prices. Through October 2008, the Company has in place a series of floors and ceilings associated with part of its natural gas production. Under the arrangements, if the applicable index rises above the ceiling price, the Company pays the counterparty; however, if the index drops below the floor, the counterparty pays us. During the three months ended December 31, 2006, the Company averaged natural gas volumes sold of 1,283,000 Mcf per month and oil sales of 52,000 barrels per month. The positions in effect as of May 10, 2007, on the Company's share of production (the table below does not include positions related to RNG activities or derivative contracts entered into by the Company on behalf of the affiliate Partnerships as the Managing General Partner) by area are shown in the following table.

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Month Set	Months Covered	Floors		Ceilings	
		Monthly Quantity Gas-MMMbtu Oil-Bbbls	Contract Price	Monthly Quantity MMbtu	Contract Price
<b>Colorado Interstate Gas (CIG) Based Hedges (Piceance Basin)</b>					
Feb-06	May 2007 – Oct 2007	44,000	\$ 5.50	-	\$ -
Sep-06	May 2007 – Oct 2007	194,500	4.50	-	-
Dec-06	Nov 2007 – Mar 2008	100,000	5.25	-	-
Jan-07	Nov 2007 – Mar 2008	100,000	5.25	100,000	9.80
May-07	Apr 2008 – Oct 2008	197,250	5.50	197,250	10.35
<b>NYMEX Based Hedges - (Appalachian and Michigan Basins)</b>					
Feb-06	May 2007 – Oct 2007	85,000	7.00	-	-
Feb-06	May 2007 – Oct 2007	85,000	7.50	34,000	10.83
Sep-06	May 2007 – Oct 2007	85,000	6.25	-	-
Jan-07	May 2007 – Oct 2007	85,000	5.25	-	-
Dec-06	Nov 2007 – Mar 2008	144,500	7.00	-	-
Jan-07	Nov 2007 – Mar 2008	144,500	7.00	153,000	13.70
Jan-07	Apr 2008 – Oct 2008	144,500	6.50	153,000	10.80
<b>Panhandle Based Hedges (NECO)</b>					
Feb-06	May 2007 – Oct 2007	60,000	6.00	-	-
Feb-06	May 2007 – Oct 2007	60,000	6.50	60,000	9.80
Jan-07	May 2007 – Oct 2007	90,000	4.50	-	-
Dec-06	Nov 2007 – Mar 2008	70,000	5.75	-	-
Jan-07	Nov 2007 – Mar 2008	90,000	6.00	90,000	11.25
Jan-07	Apr 2008 – Oct 2008	90,000	5.50	90,000	9.85
<b>DJ Basin</b>					
Jan-07	May 2007 – Oct 2007	161,000	4.00	-	-
Jan-07		90,000	5.25	90,000	9.80



Nov 2007 – Mar  
2008

Apr 2008 – Oct  
2008

May-07