PDC ENERGY, INC.
Form 10-Q
August 10, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

or

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

For the transition period from __________ to _________

Commission File Number 000-07246
PDC ENERGY, INC.
(Exact name of registrant as specified in its charter)

Delaware	95-2636730
(State of incorporation)	(I.R.S. Employer Identification No.)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes T No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes T No £

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

Large accelerated filer x	Accelerated filer o

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 40,099,702 shares of the Company's Common Stock ($0.01 par value) were outstanding as of July 17, 2015.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 ("Securities Act") and Section 21E of the Securities Exchange Act of 1934 ("Exchange Act") regarding our business, financial condition, results of operations and prospects. All statements other than statements of historical facts included in and incorporated by reference into this report are "forward-looking statements" within the meaning of the safe harbor provisions of the United States ("U.S.") Private Securities Litigation Reform Act of 1995. Words such as expects, anticipates, intends, plans, believes, seeks, estimates and similar expressions or variations of such words are intended to identify forward-looking statements herein. These statements relate to, among other things: estimated future production (including the components of such production), sales, expenses, cash flows and liquidity; estimated crude oil, natural gas and natural gas liquids (“NGLs”) reserves; expected 2015 capital forecast allocations, including revised capital and production forecasts; anticipated increased 2015 capital projects, expenditures and opportunities; expected year-end exit rates; the impact of prolonged depressed commodity prices; potential future impairments; availability of sufficient funding for our 2015 capital program and sources of that funding; future exploration, drilling and development activities, including our expected rig count; expectation of cash flow neutrality in 2016; potential additional revisions to our 2015 capital and production forecast; anticipated reductions in our 2015 cost structure; the expiration of certain significant and insignificant leases in the Utica Shale; our evaluation method of our customers' and derivative counterparties' credit risk, in light of the impact of low commodity prices on certain of our Gas Marketing customers; our expected positive net settlements on our derivative positions in 2015; effectiveness of our derivative program in providing a degree of price stability; the impact of high line pressures and the timing, availability, cost and effect of additional midstream facilities and services going forward; expected differentials; compliance with debt covenants; expected funding sources upon conversion of our 3.25% convertible senior notes due 2016; the impact of litigation on our results of operations and financial position; that we do not expect to pay dividends in the foreseeable future; and our future strategies, plans and objectives.

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

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

- changes in worldwide production volumes and demand, including economic conditions that might impact demand;
- volatility of commodity prices for crude oil, natural gas and NGLs and the risk of an extended period of depressed prices;
- impact of governmental policies and/or regulations, including changes in environmental and other laws, the interpretation and enforcement related to those laws and regulations, liabilities arising thereunder and the costs to comply with those laws and regulations;
- potential declines in the value of our crude oil, natural gas and NGLs properties resulting in impairments;
- changes in estimates of proved reserves;
- inaccuracy of reserve estimates and expected production rates;
- potential for production decline rates from our wells being greater than expected;
- timing and extent of our success in discovering, acquiring, developing and producing reserves;
- our ability to secure leases, drilling rigs, supplies and services at reasonable prices;
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availability of sufficient pipeline, gathering and other transportation facilities and related infrastructure to process and transport our production and the impact of these facilities and regional capacity on the prices we receive for our production;
- timing and receipt of necessary regulatory permits;
- risks incidental to the drilling and operation of crude oil and natural gas wells;
- future cash flows, liquidity and financial condition;
- competition within the oil and gas industry;
- availability and cost of capital;
- reductions in the borrowing base under our revolving credit facility;
- our success in marketing crude oil, natural gas and NGLs;
- effect of crude oil and natural gas derivatives activities;
- impact of environmental events, governmental and other third-party responses to such events, and our ability to insure adequately against such events;
- cost of pending or future litigation;
- effect that acquisitions we may pursue have on our capital expenditures;
- our ability to retain or attract senior management and key technical employees; and
- success of strategic plans, expectations and objectives for our future operations.

Further, we urge you to carefully review and consider the cautionary statements and disclosures, specifically those under the heading "Risk Factors," made in this Quarterly Report on Form 10-Q, our Annual Report on Form 10-K for the year ended December 31, 2014 (the "2014 Form 10-K"), filed with the U.S. Securities and Exchange Commission ("SEC") on February 19, 2015, and our other filings with the SEC for further information on risks and uncertainties that could affect our business, financial condition, results of operations and prospects, which are incorporated by this reference as though fully set forth herein. We caution you not to place undue reliance on the forward-looking statements,

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which speak only as of the date of this report. We undertake no obligation to update any forward-looking statements in order to reflect any event or circumstance occurring after the date of this report or currently unknown facts or conditions or the occurrence of unanticipated events. All forward-looking statements are qualified in their entirety by this cautionary statement.

REFERENCES

Unless the context otherwise requires, references in this report to "PDC Energy," "PDC," "the Company," "we," "us," "our" or "ours" refer to the registrant, PDC Energy, Inc. and all subsidiaries consolidated for the purposes of its financial statements, including our proportionate share of the financial position, results of operations, cash flows and operating activities of our affiliated partnerships and PDC Mountaineer, LLC ("PDCM"), a joint venture owned, until October 14, 2014, 50% each by PDC and Lime Rock Partners, LP. See Note 1, Nature of Operations and Basis of Presentation, to our condensed consolidated financial statements included elsewhere in this report for a description of our consolidated subsidiaries.

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PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PDC ENERGY, INC.
Condensed Consolidated Balance Sheets
(unaudited; in thousands, except share and per share data)

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$1,376	$16,066
Accounts receivable, net	90,005	131,204
Fair value of derivatives	155,891	187,495
Prepaid expenses and other current assets	3,678	5,954
Total current assets	250,950	340,719
Properties and equipment, net	1,985,431	1,800,186
Assets held for sale	2,874	2,874
Fair value of derivatives	69,888	112,819
Other assets	82,474	83,990
Total Assets	$2,391,617	$2,340,588
Liabilities and Shareholders' Equity		
Liabilities		
Current liabilities:		
Accounts payable	$79,709	$130,321
Production tax liability	25,952	21,314
Fair value of derivatives	1,812	570
Funds held for distribution	28,821	27,186
Current portion of long-term debt	110,998	—
Accrued interest payable	9,170	9,109
Deferred income taxes	32,914	59,174
Other accrued expenses	17,940	62,717
Total current liabilities	307,316	310,391
Long-term debt	553,000	664,923
Deferred income taxes	129,323	125,693
Asset retirement obligation	71,070	71,992
Fair value of derivatives	1,289	197
Other liabilities	13,032	30,033
Total liabilities	1,075,030	1,203,229
Commitments and contingent liabilities		
Shareholders' equity		
Preferred shares - par value $0.01 per share, 50,000,000 shares authorized, none issued	—	—
Common shares - par value $0.01 per share, 150,000,000 authorized, 40,092,754 and 35,927,985 issued as of June 30, 2015 and December 31, 2014, respectively	401	359
Additional paid-in capital	898,430	689,209

Retained earnings	418,894	448,702
Treasury shares - at cost, 21,734 and 21,643 as of June 30, 2015 and December 31, 2014, respectively	(1,138)	(911)
Total shareholders' equity	1,316,587	1,137,359
Total Liabilities and Shareholders' Equity	$2,391,617	$2,340,588

See accompanying Notes to Condensed Consolidated Financial Statements
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PDC ENERGY, INC.
Condensed Consolidated Statements of Operations
(unaudited; in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues				
Crude oil, natural gas and NGLs sales	$96,928	$131,017	$171,037	$251,030
Sales from natural gas marketing	2,523	22,415	5,756	49,352
Commodity price risk management gain (loss), net	(49,041)	(52,643)	17,621	(77,552)
Well operations, pipeline income and other	550	514	1,178	1,130
Total revenues	50,960	101,303	195,592	223,960
Costs, expenses and other				
Production costs	21,476	23,774	45,645	41,857
Cost of natural gas marketing	2,836	22,428	6,094	49,298
Exploration expense	275	276	560	583
Impairment of crude oil and natural gas properties	2,773	848	5,257	1,758
General and administrative expense	18,667	39,440	37,347	61,924
Depreciation, depletion and amortization	70,106	49,636	125,926	92,525
Accretion of asset retirement obligations	1,588	840	3,148	1,681
(Gain) loss on sale of properties and equipment	(207)	(23)	(228)	556
Total cost, expenses and other	117,514	137,219	223,749	250,182
Loss from operations	(66,554)	(35,916)	(28,157)	(26,222)
Interest expense	(11,567)	(12,195)	(23,292)	(24,378)
Interest income	1,135	83	2,248	270
Loss from continuing operations before income taxes	(76,986)	(48,028)	(49,201)	(50,330)
Provision for income taxes	30,116	18,650	19,393	19,544
Loss from continuing operations	(46,870)	(29,378)	(29,808)	(30,786)
Income from discontinued operations, net of tax	—	1,191	—	472
Net loss	$(46,870)	$(28,187)	$(29,808)	$(30,314)
Earnings per share:				
Basic				
Loss from continuing operations	$(1.17)	$(0.82)	$(0.78)	$(0.86)
Income from discontinued operations, net of tax	—	0.03	—	0.01
Net loss	$(1.17)	$(0.79)	$(0.78)	$(0.85)
Diluted				
Loss from continuing operations	$(1.17)	$(0.82)	$(0.78)	$(0.86)
Income from discontinued operations, net of tax	—	0.03	—	0.01
Net loss	$(1.17)	$(0.79)	$(0.78)	$(0.85)
Weighted-average common shares outstanding:				
Basic	40,035	35,762	38,202	35,726
Diluted	40,035	35,762	38,202	35,726

See accompanying Notes to Condensed Consolidated Financial Statements

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PDC ENERGY, INC.
Condensed Consolidated Statements of Cash Flows
(unaudited; in thousands)

	Six Months Ended June 30, 2015	2014
Cash flows from operating activities:		
Net loss	$(29,808)	$(30,314)
Adjustments to net loss to reconcile to net cash from operating activities:		
Net change in fair value of unsettled derivatives	76,869	61,953
Depreciation, depletion and amortization	125,926	100,382
Impairment of crude oil and natural gas properties	5,257	1,917
Accretion of asset retirement obligation	3,148	1,716
Stock-based compensation	9,465	8,879
(Gain) loss on sale of properties and equipment	(228)	362
Amortization of debt discount and issuance costs	3,521	3,443
Deferred income taxes	(22,630)	(23,563)
Non-cash interest income	(2,247)	—
Other	1,517	(90)
Changes in assets and liabilities	(24,333)	6,905
Net cash from operating activities	146,457	131,590
Cash flows from investing activities:		
Capital expenditures	(358,135)	(293,648)
Proceeds from sale of properties and equipment	243	1,449
Net cash from investing activities	(357,892)	(292,199)
Cash flows from financing activities:		
Proceeds from sale of common stock, net of issuance costs	202,851	—
Proceeds from revolving credit facility	272,000	17,000
Repayment of revolving credit facility	(275,000)	(7,000)
Other	(3,106)	(2,277)
Net cash from financing activities	196,745	7,723
Net change in cash and cash equivalents	(14,690)	(152,886)
Cash and cash equivalents, beginning of period	16,066	193,243
Cash and cash equivalents, end of period	$1,376	$40,357
Supplemental cash flow information:		
Cash payments for:		
Interest, net of capitalized interest	$22,828	$23,724
Income taxes	9,936	1,800
Non-cash investing and financing activities:		
Change in accounts payable related to purchases of properties and equipment	$(41,490)	$(6,962)
Change in asset retirement obligation, with a corresponding change to crude oil and natural gas properties, net of disposals	1,395	341
Purchase of properties and equipment under capital leases	950	—

NOTE 1 - NATURE OF OPERATIONS AND BASIS OF PRESENTATION

PDC Energy, Inc. is a domestic independent exploration and production company that produces, develops, acquires and explores for crude oil, natural gas and NGLs, with primary operations in the Wattenberg Field in Colorado and the Utica Shale in southeastern Ohio. Our operations in the Wattenberg Field are focused in the horizontal Niobrara and Codell plays and our Ohio operations are focused in the Utica Shale play. As of June 30, 2015, we owned an interest in approximately 2,900 gross wells. We are engaged in two business segments: Oil and Gas Exploration and Production and Gas Marketing. In October 2014, we sold our entire 50% ownership interest in our joint venture, PDCM, to an unrelated third-party.

The accompanying unaudited condensed consolidated financial statements include the accounts of PDC, our wholly-owned subsidiary Riley Natural Gas ("RNG"), our proportionate share of our four affiliated partnerships and, for the three and six months ended June 30, 2014, our proportionate share of PDCM. Pursuant to the proportionate consolidation method, our accompanying condensed consolidated financial statements include our pro rata share of assets, liabilities, revenues and expenses of the entities which we proportionately consolidate. All material intercompany accounts and transactions have been eliminated in consolidation.

In our opinion, the accompanying condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of our financial statements for interim periods in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, pursuant to such rules and regulations, certain notes and other financial information included in audited financial statements have been condensed or omitted. The information presented in this Quarterly Report on Form 10-Q should be read in conjunction with our audited consolidated financial statements and notes thereto included in our 2014 Form 10-K. Our results of operations and cash flows for the three and six months ended June 30, 2015 are not necessarily indicative of the results to be expected for the full year or any other future period.

Certain reclassifications have been made to prior period financial statements to conform to the current year presentation. The reclassifications are mainly attributable to reporting the results of operations related to PDCM's Marcellus Shale assets as discontinued operations. These reclassifications had no impact on previously reported cash flows, net income, earnings per share or shareholders' equity.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Recently Adopted Accounting Standards

On January 1, 2014, we adopted changes issued by the Financial Accounting Standards Board ("FASB") regarding the accounting for income taxes. The change provides clarification on the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. Adoption of these changes had no impact on the condensed consolidated financial statements.

In April 2014, the FASB issued changes related to the criteria for determining which disposals can be presented as discontinued operations and modified related disclosure requirements. Under the new pronouncement, a discontinued operation is defined as a component of an entity that either has been disposed of or is classified as held for sale and represents a strategic shift that has a major effect on the entity's operations and financial results. These changes were required to be applied prospectively for new disposals or components of an entity classified as held for sale during interim and annual periods beginning after December 15, 2014, with early adoption permitted. On July 1, 2014, we elected to early adopt the new pronouncement.

Recently Issued Accounting Standards

In May 2014, the FASB and the International Accounting Standards Board ("IASB") issued their converged standard on revenue recognition that provides a single, comprehensive model that entities will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The standard outlines a five-step approach to apply the underlying principle: (a) identify the contract with the customer, (b) identify the separate performance obligations in the contract, (c) determine the transaction price, (d) allocate the transaction price to separate performance obligations and (e) recognize revenue when (or as) each performance obligation is satisfied. The revenue standard is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, and can be adopted under the full retrospective method or simplified transition method. Entities are permitted to adopt the revenue standard early, beginning with annual reporting periods after December 15, 2016. We are currently evaluating the impact these changes will have on our condensed consolidated financial statements.

In August 2014, the FASB issued a new standard related to the disclosure of uncertainties about an entity's ability to continue as a going concern. The new standard will explicitly require management to assess an entity's ability to continue as a going concern every reporting period and to provide related footnote disclosures in certain circumstances. The new standard will be effective for all entities in the first annual period ending after December 15, 2016, with early adoption permitted. Adoption of this guidance is not expected to have a significant impact on our condensed consolidated financial statements.

In November 2014, the FASB issued an update to accounting for derivatives and hedging instruments. The update clarifies how current accounting guidance should be interpreted in evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Specifically, the accounting update clarifies that an entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, in evaluating the nature of the host contract. Furthermore, the update clarifies that no single term or feature would necessarily determine the economic characteristics and risks of the host contract. Rather, the nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument. The assessment of the substance of the relevant terms and features should incorporate a consideration of the characteristics of the terms and features themselves, the circumstances under which the hybrid financial instrument was issued or acquired, and the potential outcomes of the hybrid financial instrument, as well as the likelihood of those potential outcomes. The accounting update is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. We are currently evaluating the impact these changes will have on our condensed consolidated financial statements.

In January 2015, the FASB issued new accounting guidance eliminating from current accounting guidance the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. This guidance is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. Adoption of this guidance is not expected to have a significant impact on our condensed consolidated financial statements.

In February 2015, the FASB issued an accounting update modifying existing consolidation guidance for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. The amendments in this update are effective for fiscal years and interim periods within those years beginning after December 15, 2015, and require either a retrospective or a modified retrospective approach to adoption. Early adoption is permitted. Adoption of this guidance is not expected to have a significant impact on our condensed consolidated financial statements or disclosures.

In April 2015, the FASB issued an accounting update simplifying the presentation of debt issuance costs and requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The update did not affect the recognition and measurement guidance for debt issuance costs. This guidance is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. Adoption of this guidance is not expected to have a significant impact on our condensed consolidated financial statements or disclosures.

NOTE 3 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Derivative Financial Instruments

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

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

Level 2 – Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for the asset or liability, including quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived from observable market data by correlation or other means.

Level 3 – Unobservable inputs for the asset or liability, including situations where there is little, if any, market activity.

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

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

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PDC ENERGY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Our fixed-price swaps, basis swaps and physical purchases are included in Level 2 and our collars and physical sales are included in Level 3. The following table presents, for each applicable level within the fair value hierarchy, our derivative assets and liabilities, including both current and non-current portions, measured at fair value on a recurring basis:

	June 30, 2015			December 31, 2014		
	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(in thousands)					
Assets:						
Commodity-based derivative contracts	$167,362	$58,417	$225,779	$237,939	$62,356	$300,295
Basis protection derivative contracts	—	—	—	19	—	19
Total assets	167,362	58,417	225,779	237,958	62,356	300,314
Liabilities:						
Commodity-based derivative contracts	1,016	162	1,178	742	—	742
Basis protection derivative contracts	1,923	—	1,923	25	—	25
Total liabilities	2,939	162	3,101	767	—	767
Net asset	$164,423	$58,255	$222,678	$237,191	$62,356	$299,547

The following table presents a reconciliation of our Level 3 assets measured at fair value:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Fair value, net asset, beginning of period	$74,817	$(129)	$62,356	$1,111
Changes in fair value included in statement of operations line item:				
Commodity price risk management gain (loss), net	(10,749)	(7,454)	4,440	(8,797)
Sales from natural gas marketing	(1)	(4)	—	(26)
Settlements included in statement of operations line items:				
Commodity price risk management gain (loss), net	(5,809)	621	(8,534)	740
Sales from natural gas marketing	(3)	(1)	(7)	5
Fair value, net asset (liability) end of period	$58,255	$(6,967)	$58,255	$(6,967)
Net change in fair value of unsettled derivatives included in statement of operations line item:				
Commodity price risk management gain (loss), net	$(10,056)	$(2,993)	$3,629	$(4,227)
Sales from natural gas marketing	—	(2)	—	(4)
Total	$(10,056)	$(2,995)	$3,629	$(4,231)

The significant unobservable input used in the fair value measurement of our derivative contracts is the implied volatility curve, which is provided by a third-party vendor. A significant increase or decrease in the implied volatility, in isolation, would have a directionally similar effect resulting in a significantly higher or lower fair value measurement of our Level 3 derivative contracts. There has been no change in the methodology we apply to measure the fair value of our Level 3 derivative contracts.

Non-Derivative Financial Assets and Liabilities

The carrying value of the financial instruments included in current assets and current liabilities, excluding the current portion of long-term debt, approximate fair value due to the short-term maturities of these instruments.

The liability associated with our non-qualified deferred compensation plan for non-employee directors may be settled in cash or shares of our common stock. The carrying value of this obligation is based on the quoted market price of our common stock, which is a Level 1 input. The liability related to this plan, which was included in other liabilities on the condensed consolidated balance sheets, was immaterial as of June 30, 2015 and December 31, 2014.

The portion of our long-term debt related to our revolving credit facility approximates fair value due to the variable nature of related interest rates. We have not elected to account for the portion of our debt related to our senior notes under the fair value option; however, as of June 30, 2015, we estimate the fair value of the portion of our long-term debt related to our 3.25% convertible senior notes due 2016 to be $155.9 million, or 135.6% of par value, and the portion related to our 7.75% senior notes due 2022 to be $527.2 million, or 105.4% of par value. We determined these valuations based upon measurements of trading activity and broker and/or dealer quotes, respectively, which are published market prices, and therefore are Level 2 inputs.

The carrying value of our capital lease obligations approximates fair value as it represents the present value of future lease payments.

Concentration of Risk

Derivative Counterparties. Our derivative arrangements expose us to credit risk of nonperformance by our counterparties. We primarily use financial institutions who are also lenders under our revolving credit facility as counterparties to our derivative contracts. To date, we have had no counterparty default losses relating to our derivative arrangements. We have evaluated the credit risk of our derivative assets from our counterparties using relevant credit market default rates, giving consideration to amounts outstanding for each counterparty and the duration of each outstanding derivative position. Based on our evaluation, we have determined that the potential impact of nonperformance of our counterparties on the fair value of our derivative instruments was not significant at June 30, 2015, taking into account the estimated likelihood of nonperformance.

The following table presents the counterparties that expose us to credit risk as of June 30, 2015 with regard to our derivative assets:

Counterparty Name	Fair Value of Derivative Assets (in thousands)
JP Morgan Chase Bank, N.A (1)	$63,200
Canadian Imperial Bank of Commerce (1)	53,050
Wells Fargo Bank, N.A. (1)	34,072
NATIXIS (1)	28,169
Bank of Nova Scotia (1)	26,938
Key Bank N.A. (1)	14,962
Other lenders in our revolving credit facility	5,388
Total	$225,779

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(1)Major lender in our revolving credit facility. See Note 7, Long-Term Debt.

Note Receivable. The following table presents information regarding our note receivable outstanding as of June 30, 2015:

	Amount (in thousands)
Note Receivable:	
Principal outstanding, December 31, 2014	$39,707
Paid-In-Kind interest	1,604

Principal outstanding, June 30, 2015	$41,311

In October 2014, we sold our entire 50% ownership interest in PDCM to an unrelated third-party. See Note 13, Assets Held for Sale, Divestitures and Discontinued Operations, for additional information regarding the sale. As part of the consideration, we received a promissory note (the “Note”) for a principal sum of $39.0 million, bearing interest at varying rates beginning at 8%, and increasing annually. Pursuant to the Note agreement, interest shall be paid quarterly, in arrears, commencing in December 2014 and continuing on the last business day of each fiscal quarter thereafter. At the option of the issuer of the Note, an unrelated third-party, interest can be paid-in-kind (the “PIK Interest”) and any such PIK Interest will be added to the outstanding principal amount of the Note. As of June 30, 2015, the issuer of the Note had elected the PIK Interest option. The principal and any unpaid interest shall be due and payable in full in September 2020 and can be prepaid in whole or in part at any time, and in certain circumstances must be repaid prior to maturity. Any such prepayment will be made without premium or penalty. The Note is secured by a pledge of stock in certain subsidiaries of the unrelated third-party, debt securities and other assets.

Under the effective interest method, we recognized $1.1 million and $2.2 million of interest income for the three and six months ended June 30, 2015, respectively, of which $0.8 million and $1.6 million, respectively, was PIK Interest. As of June 30, 2015, the $41.3 million outstanding balance on the Note was included in the condensed consolidated balance sheet line item other assets.

NOTE 4 - DERIVATIVE FINANCIAL INSTRUMENTS

Our results of operations and operating cash flows are affected by changes in market prices for crude oil, natural gas and NGLs. To manage a portion of our exposure to price volatility from producing crude oil and natural gas, we utilize the following economic hedging strategies for each of our business segments.

- For crude oil and natural gas sales, we enter into derivative contracts to protect against price declines in future periods. While we structure these derivatives to reduce our exposure to changes in price associated with the derivative commodity, they also limit the benefit we might otherwise have received from price increases in the physical market; and

- For natural gas marketing, we enter into fixed-price physical purchase and sale agreements that qualify as derivative contracts. In order to offset the fixed-price physical derivatives in our natural gas marketing, we enter into financial derivative instruments that have the effect of locking in the prices we will receive or pay for the same volumes and period, offsetting the physical derivative.

We believe our derivative instruments continue to be effective in achieving the risk management objectives for which they were intended. As of June 30, 2015, we had derivative instruments, which were comprised of collars, fixed-price swaps, basis protection swaps and physical sales and purchases, in place for a portion of our anticipated production through 2017 for a total of 76,328 BBtu of natural gas and 8,127 MBbls of crude oil. The majority of our derivative contracts are entered into at no cost to us as we hedge our anticipated production at the then-prevailing commodity market prices.

We have elected not to designate any of our derivative instruments as hedges, and therefore do not qualify for use of hedge accounting. Accordingly, changes in the fair value of our derivative instruments are recorded in the statements of operations. Changes in the fair value of derivative instruments related to our Oil and Gas Exploration and Production segment are recorded in commodity price risk management, net. Changes in the fair value of derivative instruments related to our Gas Marketing segment are recorded in sales from and cost of natural gas marketing.

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PDC ENERGY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

The following table presents the balance sheet location and fair value amounts of our derivative instruments on the condensed consolidated balance sheets:

Derivative instruments:		Balance sheet line item	Fair Value June 30, 2015	December 31, 2014
			(in thousands)	
Derivative assets:	Current			
	Commodity contracts			
	Related to crude oil and natural gas sales	Fair value of derivatives	$155,516	$186,886
	Related to natural gas marketing	Fair value of derivatives	375	590
	Basis protection contracts			
	Related to crude oil and natural gas sales	Fair value of derivatives	—	19
			155,891	187,495
	Non-current			
	Commodity contracts			
	Related to crude oil and natural gas sales	Fair value of derivatives	69,746	112,599
	Related to natural gas marketing	Fair value of derivatives	142	220
			69,888	112,819
Total derivative assets			$225,779	$300,314
Derivative liabilities:	Current			
	Commodity contracts			
	Related to natural gas marketing	Fair value of derivatives	$348	$545
	Basis protection contracts			
	Related to crude oil and natural gas sales	Fair value of derivatives	1,464	25
			1,812	570
	Non-current			
	Commodity contracts			