Rosetta Resources Inc.
Form 10-Q
May 06, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**
For The Quarterly Period Ended March 31, 2011

OR

¨ **Transition Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number: 000-51801

ROSETTA RESOURCES INC.

(Exact name of registrant as specified in its charter)

Delaware	**43-2083519**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
717 Texas, Suite 2800, Houston, TX	**77002**
(Address of principal executive offices)	**(Zip Code)**

(Registrant s telephone number, including area code) (713) 335-4000

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 x 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 Securities Exchange Act of 1934.

Large accelerated filer	x	Accelerated filer	¨
Non-Accelerated filer	¨ (Do not check if smaller reporting company)	Smaller Reporting Company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ¨ No x

The number of shares of the registrant s Common Stock, $.001 par value per share, outstanding as of May 2, 2011 was 52,993,563.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Rosetta Resources Inc.

Consolidated Balance Sheet

(In thousands, except par value and share amounts)

	March 31, 2011 (Unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 81,904	$ 41,634
Accounts receivable, net	48,399	44,028
Derivative instruments	5,154	19,145
Prepaid expenses	3,280	2,711
Other current assets	5,287	5,454
Deferred tax assets	407	
Total current assets	144,431	112,972
Oil and natural gas properties, full cost method, of which $94,691 thousand at March 31, 2011 and $91,148 thousand at December 31, 2010 were excluded from amortization	2,296,563	2,262,161
Other fixed assets	15,031	14,459
	2,311,594	2,276,620
Accumulated depreciation, depletion, and amortization, including impairment	(1,578,714)	(1,546,631)
Total property and equipment, net	732,880	729,989
Deferred loan fees	7,033	7,652
Deferred tax asset	144,122	142,710
Derivative instruments		1,523
Other assets	2,482	2,463
Total other assets	153,637	154,348
Total assets	$ 1,030,948	$ 997,309
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 4,690	$ 3,669
Accrued liabilities	101,991	57,006
Royalties payable	11,985	14,542
Derivative instruments	7,100	
Prepayment on gas sales	6,534	7,869
Deferred income taxes		7,132
Total current liabilities	132,300	90,218

Long-term liabilities:		
Derivative instruments	14,307	1,011
Long-term debt	350,000	350,000
Other long-term liabilities	19,055	27,264
Total liabilities	515,662	468,493
Commitments and Contingencies (Note 9)		
Stockholders equity:		
Preferred stock, $0.001 par value; authorized 5,000,000 shares; no shares issued in 2011 or 2010		
Common stock, $0.001 par value; authorized 150,000,000 shares; issued 52,364,268 shares and 52,031,004 shares at March 31, 2011 and December 31, 2010, respectively	52	52
Additional paid-in capital	796,086	793,293
Treasury stock, at cost; 426,320 and 343,093 shares at March 31, 2011 and December 31, 2010, respectively	(10,232)	(6,896)
Accumulated other comprehensive (loss) income	(12,725)	11,259
Accumulated deficit	(257,895)	(268,892)
Total stockholders equity	515,286	528,816
Total liabilities and stockholders equity	$ 1,030,948	$ 997,309

The accompanying notes to the financial statements are an integral part hereof.

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Rosetta Resources Inc.

Consolidated Statement of Operations

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Revenues:		
Natural gas sales	$ 49,780	$ 55,807
Oil sales	28,749	6,983
NGL sales	18,542	7,358
Total revenues	97,071	70,148
Operating costs and expenses:		
Lease operating expense	14,520	14,677
Depreciation, depletion, and amortization	34,029	23,814
Treating, transportation and marketing	3,451	1,481
Production taxes	1,656	2,290
General and administrative costs	21,070	11,807
Total operating costs and expenses	74,726	54,069
Operating income	22,345	16,079
Other (income) expense:		
Interest expense, net of interest capitalized	6,346	4,746
Interest (income)	(28)	(11)
Other expense (income), net	273	(203)
Total other expense	6,591	4,532
Income before provision for income taxes	15,754	11,547
Income tax expense	4,757	4,284
Net income	$ 10,997	$ 7,263
Earnings per share:		
Basic	$ 0.21	$ 0.14
Diluted	$ 0.21	$ 0.14
Weighted average shares outstanding:		
Basic	51,854	51,219
Diluted	52,521	51,920

The accompanying notes to the financial statements are an integral part hereof.

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Rosetta Resources Inc.

Consolidated Statement of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Cash flows from operating activities		
Net income	$ 10,997	$ 7,263
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation, depletion and amortization	34,029	23,814
Deferred income taxes	5,842	4,164
Amortization of deferred loan fees recorded as interest expense	595	481
Amortization of original issue discount recorded as interest expense		114
Stock compensation expense	10,590	2,631
Realized gain on derivative instruments	(2,867)	
Change in operating assets and liabilities:		
Accounts receivable	(4,371)	248
Prepaid expenses	(542)	643
Other current assets	167	922
Other assets	(20)	(8)
Accounts payable	1,021	1,264
Accrued liabilities	759	(2,762)
Royalties payable	(3,893)	(1,894)
Other long-term operating liabilities	(46)	
Net cash provided by operating activities	52,261	36,880
Cash flows from investing activities		
Additions of oil and gas assets	(70,741)	(73,591)
Disposals of oil and gas properties and assets	60,953	21
Net cash used in investing activities	(9,788)	(73,570)
Cash flows from financing activities		
Borrowings on revolving credit facility		25,000
Proceeds from stock options exercised	1,132	1,591
Purchases of treasury stock	(3,335)	(1,250)
Net cash (used in) provided by financing activities	(2,203)	25,341
Net increase (decrease) in cash	40,270	(11,349)
Cash and cash equivalents, beginning of period	41,634	61,256
Cash and cash equivalents, end of period	$ 81,904	$ 49,907
Supplemental disclosures:		
Capital expenditures included in accrued liabilities	$ 40,181	$ 25,027

The accompanying notes to the financial statements are an integral part hereof.

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Rosetta Resources Inc.

Notes to Consolidated Financial Statements (unaudited)

(1) Organization and Operations of the Company

Nature of Operations. Rosetta Resources Inc. (together with its consolidated subsidiaries, the Company) is an independent oil and gas company engaged in onshore oil and natural gas exploration, development, production and acquisition activities in the United States. The Company s operations are concentrated in South Texas, primarily in the Eagle Ford shale, and in the Southern Alberta Basin in northwest Montana.

These interim financial statements have not been audited. However, in the opinion of management, all adjustments, consisting of only normal recurring adjustments necessary to fairly state the financial statements, have been included. Results of operations for interim periods are not necessarily indicative of the results of operations that may be expected for the entire year. In addition, these financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all disclosures required for financial statements prepared in conformity with accounting principles generally accepted in the United States of America. These financial statements and notes should be read in conjunction with the Company s audited Consolidated Financial Statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010 (2010 Annual Report).

Certain reclassifications of prior year balances have been made to conform them to the current year presentation. These reclassifications have no impact on net income.

(2) Summary of Significant Accounting Policies

The Company has provided a discussion of significant accounting policies, estimates and judgments in its 2010 Annual Report.

Recent Accounting Developments

The following recently issued accounting developments have been applied or may impact the Company in future periods.

Fair Value Measurements. In January 2010, the Financial Accounting Standards Board (FASB) issued authoritative guidance related to improving disclosures about fair value measurements. This guidance requires separate disclosures of the amounts of transfers in and out of Level 1 and Level 2 fair value measurements and a description of the reason for such transfers. In the reconciliation for Level 3 fair value measurements using significant unobservable inputs, information about purchases, sales, issuances and settlements shall be presented separately. These disclosures will be required for interim and annual reporting periods effective January 1, 2010, except for the disclosures related to the purchases, sales, issuances and settlements in the roll forward activity of Level 3 fair value measurements, which are effective on January 1, 2011. This guidance requires additional disclosures but did not impact our consolidated financial position, results of operations or cash flows. See Note 5 Fair Value Measurements.

(3) Property and Equipment

The Company s total property and equipment consists of the following:

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	March 31, 2011	December 31, 2010
	(In thousands)	
Proved properties	$ 2,161,349	$ 2,124,615
Unproved/unevaluated properties	94,691	91,148
Gas gathering system and compressor stations	40,523	46,398
Other fixed assets	15,031	14,459
Total property and equipment, gross	2,311,594	2,276,620
Less: Accumulated depreciation, depletion, and amortization, including impairment	(1,578,714)	(1,546,631)
Total property and equipment, net	$ 732,880	$ 729,989

As part of our strategic decision to focus on the development of the Eagle Ford shale, the Company executed a purchase and sale agreement on February 22, 2011 for $55.0 million for the divestiture of the DJ Basin assets in Colorado. The sale of these assets closed on March 31, 2011 with an effective date of January 1, 2011 and the agreement was subject to due diligence and post-closing purchase price adjustments. Proceeds from the divestiture were recorded as an adjustment to the full cost pool with no gain or loss recognized.

Subsequently, on February 24, 2011, the Company executed a purchase and sale agreement for $200.0 million for the divestiture of the Sacramento Basin assets in California. The sale of these assets closed on April 15, 2011 with an effective date of January 1, 2011. The agreement was also subject to post-closing purchase price adjustments. Approximately $43.6 million associated with a certain portion of the properties was placed in escrow pending the Company s receipt of appropriate consents for assignment. On April 25, 2011 and May 4, 2011, the Company closed on a portion of the properties for which consents were received after the first closing. The Company has accordingly received from the escrow account approximately $7.8 million and $5.6 million, respectively, for these properties, which have been conveyed to the buyer. Once the Company is in receipt of the outstanding consents, title to these remaining properties will be released to the purchaser and the residual escrowed funds will be remitted to the Company. The completion of the remaining transaction is anticipated to occur in the third quarter of 2011. The Company does not expect a gain or a loss to be recognized as a result of this transaction and the proceeds will be recorded as an adjustment to the full cost pool.

The Company capitalizes internal costs directly identified with acquisition, exploration and development activities. The Company capitalized $1.5 million and $1.7 million of internal costs for the three months ended March 31, 2011 and 2010, respectively.

Included in the Company s oil and gas properties are asset retirement costs of $18.0 million and $18.7 million as of March 31, 2011 and December 31, 2010, respectively.

Oil and gas properties include costs of $94.7 million and $91.1 million as of March 31, 2011 and December 31, 2010, respectively, which were excluded from amortized capitalized costs. These amounts primarily represent acquisition costs of unproved properties and unevaluated exploration projects in which the Company owns a direct interest. The increase from December 31, 2010 to March 31, 2011 is a result of leasehold acquisitions and the costs associated with unevaluated wells in the Southern Alberta Basin and in the Eagle Ford shale.

Pursuant to full cost accounting rules, the Company must perform a ceiling test each quarter on its oil and gas assets within each separate cost center. The Company s ceiling test was calculated using a trailing twelve-month, unweighted-average first-day-of-the-month price, adjusted for hedges, of gas and oil as of March 31, 2011, which were based on a Henry Hub gas price of $4.10 per MMBtu and a West Texas Intermediate oil price of $80.04 per Bbl (adjusted for basis and quality differentials), respectively. Utilizing these prices, the calculated ceiling amount exceeded the net capitalized cost of oil and gas properties. As a result, no write-down was recorded at March 31, 2011. It is possible that a write-down of the Company s oil and gas properties could occur in the future should oil and natural gas prices decline, the Company experiences significant downward adjustments to its estimated proved reserves, and/or the Company s commodity hedges settle and are not replaced.

In 2010, the Company s ceiling test was also calculated using a trailing twelve-month, unweighted-average first-day-of-the-month price, adjusted for hedges, of gas and oil as of March 31, 2010, which were based on a Henry Hub gas price of $3.98 per MMBtu and a West Texas Intermediate oil price of $66.13 per Bbl (adjusted for basis and quality differentials), respectively. Utilizing these prices, the calculated ceiling amount also exceeded the net capitalized cost of oil and gas properties. As a result, no write-down was recorded for the quarter ended March 31, 2010.

(4) Commodity Hedging Contracts and Other Derivatives

At March 31, 2011, the following financial fixed price swap and costless collar transactions were outstanding with associated notional volumes and average underlying prices that represent hedged prices of commodities at various market locations:

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Product	Settlement Period	Derivative Instrument	Hedge Strategy	Notional Daily Volume MMBtu	Total of Notional Volume MMBtu	Average Floor/Fixed Prices per MMBtu	Average Ceiling Prices per MMBtu	Fair Market Value Asset/(Liability) (In thousands)
Natural gas	2011	Swap	Cash flow	15,000	4,125,000	$ 5.99	$	$ 6,058
Natural gas	2011	Costless Collar	Cash flow	35,000	9,625,000	5.79	7.27	11,905
Natural gas	2012	Costless Collar	Cash flow	20,000	7,320,000	5.13	6.31	3,571
					21,070,000			$ 21,534

Product	Settlement Period	Derivative Instrument	Hedge Strategy	Notional Daily Volume Bbl	Total of Notional Volume Bbl	Average Floor/Fixed Prices per Bbl	Average Ceiling Prices per Bbl	Fair Market Value Asset/ (Liability) (In thousands)
Crude oil	2011	Costless Collar	Cash flow	3,400	935,000	$ 75.59	$ 103.29	$ (9,291)
Crude oil	2012	Costless Collar	Cash flow	3,400	1,244,400	75.88	108.00	(11,070)
Crude oil	2013	Costless Collar	Cash flow	2,600	949,000	75.00	124.65	(2,226)
					3,128,400			$ (22,587)
NGL - Propane	2011	Swap	Cash flow	1,000	275,000	$ 47.98	$	$ (2,800)
NGL - Isobutane	2011	Swap	Cash flow	270	74,250	64.02		(1,234)
NGL - Normal Butane	2011	Swap	Cash flow	330	90,750	63.79		(1,298)
NGL - Pentanes Plus	2011	Swap	Cash flow	400	110,000	83.04		(2,385)
NGL - Propane	2012	Swap	Cash flow	1,000	366,000	47.20		(3,253)
NGL - Isobutane	2012	Swap	Cash flow	260	95,160	66.63		(980)
NGL - Normal Butane	2012	Swap	Cash flow	280	102,480	65.30		(996)
NGL - Pentanes Plus	2012	Swap	Cash flow	410	150,060	86.62		(2,254)
					1,263,700			$ (15,200)

The Company s current cash flow hedge positions are with counterparties who are lenders in the Company s credit facilities. This eliminates the need for independent collateral postings with respect to any margin obligation resulting from a negative change in fair market value of the derivative contracts in connection with the Company s hedge related credit obligations. As of March 31, 2011, the Company had no deposits for collateral in regards to commodity hedge positions.

The following table sets forth the results of derivative settlements for the respective periods as reflected in the Consolidated Statement of Operations:

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Natural Gas		
Quantity settled (MMBtu)	4,500,000	2,250,000
Increase in natural gas sales revenue (In thousands) (1)	$ 7,271	$ 2,877
Crude Oil		
Quantity settled (Bbl)	24,800	
Decrease in crude oil sales revenue (In thousands)	$ (321)	$
NGL		
Quantity settled (Bbl)	63,000	
Decrease in NGL sales revenue (In thousands)	$ (1,186)	$

Interest Rate Swaps				
(Increase) in interest expense (In thousands)	$		$	(252)

(1) Excludes approximately $2.9 million of realized gain associated with the 2011 terminations of derivatives used to hedge production from divested DJ Basin properties.

As of March 31, 2011, the Company expects to reclassify net losses of $1.9 million from Accumulated other comprehensive income on the Consolidated Balance Sheet to earnings based upon settlement dates in the next twelve months and based upon current forward prices as of March 31, 2011.

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Subsequent to March 31, 2011, the Company terminated existing hedge transactions and entered into additional hedging transactions to hedge a portion of expected future natural gas production. See Note 15 Subsequent Events.

The Company is exposed to certain risks relating to its ongoing business operations. The primary risks managed through derivative instruments are commodity price risk and interest rate risk. Forward contracts on various commodities are entered into to manage the price risk associated with forecasted sales of the Company s natural gas, oil and NGL production. Interest rate swaps are utilized to manage interest rate risk associated with the Company s variable-rate borrowings.

Authoritative guidance for derivatives requires companies to recognize all derivative instruments as either assets or liabilities at fair value in the statement of financial position. In accordance with this guidance, the Company designates commodity forward contracts as cash flow hedges of forecasted sales of natural gas, oil and NGL production and interest rate swaps as cash flow hedges of interest rate payments due under variable-rate borrowings.

Additional Disclosures about Derivative Instruments and Hedging Activities

Cash Flow Hedges

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

As of March 31, 2011, the Company had outstanding natural gas, oil and NGL commodity forward contracts with notional volumes of 21,070,000 MMBtus, 3,128,400 Bbls and 1,263,700 Bbls, respectively, that were entered into to hedge forecasted natural gas, oil and NGL sales.

Information on the location and amounts of derivative fair values in the Consolidated Balance Sheet as of March 31, 2011 and December 31, 2010 and derivative gains and losses in the Consolidated Statement of Operations for the three months ended March 31, 2011 and 2010, respectively, is as follows:

Fair Values of Derivative Instruments
Derivative Assets (Liabilities)

	Balance Sheet Location	**Fair Value**	
		March 31, 2011	**December 31, 2010**
		(In thousands)	
Derivatives designated as hedging instruments			
Commodity contracts - natural gas	Derivative instruments - current assets	11,069	24,959
Commodity contracts - natural gas	Derivative instruments - non-current assets		3,614
Commodity contracts - crude oil	Derivative instruments - current assets		(2,696)
Commodity contracts - crude oil	Derivative instruments - non-current assets		(2,207)
Commodity contracts - NGL	Derivative instruments - current assets	(5,915)	(3,118)
Commodity contracts - NGL	Derivative instruments - non-current assets		116
Commodity contracts - natural gas	Derivative instruments - current liabilities	7,741	
Commodity contracts - natural gas	Derivative instruments - long-term liabilities	2,725	
Commodity contracts - crude oil	Derivative instruments - current liabilities	(11,410)	
Commodity contracts - crude oil	Derivative instruments - long-term liabilities	(11,178)	
Commodity contracts - NGL	Derivative instruments - current liabilities	(3,431)	
Commodity contracts - NGL	Derivative instruments - long-term liabilities	(5,854)	(1,011)
Total derivatives designated as hedging instruments		$ (16,253)	$ 19,657
Total derivatives not designated as hedging instruments		$	$

Total derivatives	$ (16,253)	$ 19,657

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Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Three Months Ended March 31, 2011 (In thousands)		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Three Months Ended March 31, 2011 (In thousands)		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) (1) Three Months Ended March 31, 2011 (In thousands)	
Commodity contracts - natural gas		656	Natural gas sales		7,271	Natural gas sales		2,867
Commodity contracts - crude oil		(18,005)	Crude oil sales		(321)	Crude oil sales		
Commodity contracts - NGL		(12,373)	NGL sales		(1,186)	NGL sales		
Total	$	(29,722)	Total	$	5,764	Total	$	2,867

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Three Months Ended March 31, 2010 (In thousands)		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Three Months Ended March 31, 2010 (In thousands)		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) Three Months Ended March 31, 2010 (In thousands)	
Interest rate swap	$	(263)	Interest expense, net of interest capitalized	$	(252)	Interest expense, net of interest capitalized	$	
Commodity contracts - natural gas								