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SPINNAKER EXPLORATION CO
Form 10-Q
November 08, 2001

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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 September 30, 2001.
- () Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Commission file number 001-16009

SPINNAKER EXPLORATION COMPANY
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

76-0560101
(I.R.S. Employer Identification No.)

1200 Smith Street, Suite 800
Houston, Texas
(Address of principal executive offices)

77002
(Zip Code)

(713) 759-1770
(Registrant's telephone number, including area code)

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 []

The number of shares outstanding of the registrant's common stock, par value \$0.01 per share, on November 7, 2001 was 27,203,743.

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SPINNAKER EXPLORATION COMPANY
Form 10-Q
For the Three and Nine Months Ended September 30, 2001

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SPINNAKER EXPLORATION COMPANY
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

ASSETS

CURRENT ASSETS:

| | |
|--------------------------------|----|
| Cash and cash equivalents..... | \$ |
| Short-term investments..... | |
| Accounts receivable..... | |
| Hedging assets..... | |
| Other..... | |

Total current assets.....

PROPERTY AND EQUIPMENT:

| | |
|--|--|
| Oil and gas, on the basis of full-cost accounting: | |
| Proved properties..... | |
| Unproved properties and properties under development, not being amortized..... | |
| Other..... | |

Less - Accumulated depreciation, depletion and amortization.....

Total property and equipment.....

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| | | | |
|--|--|--|----|
| OTHER ASSETS..... | | | |
| Total assets..... | | | \$ |
| LIABILITIES AND EQUITY | | | |
| CURRENT LIABILITIES: | | | |
| Accounts payable..... | | | \$ |
| Accrued liabilities..... | | | |
| Total current liabilities..... | | | |
| DEFERRED INCOME TAXES..... | | | |
| COMMITMENTS AND CONTINGENCIES | | | |
| EQUITY: | | | |
| Preferred stock, \$0.01 par value; 10,000,000 shares authorized; no shares issued and outstanding at September 30, 2001 and December 31, 2000..... | | | |
| Common stock, \$0.01 par value; 50,000,000 shares authorized; 27,202,403 shares issued and 27,186,275 shares outstanding at September 30, 2001; and 26,494,593 shares issued and 26,476,817 shares outstanding at December 31, 2000..... | | | |
| Additional paid-in capital..... | | | |
| Retained earnings..... | | | |
| Less: Treasury stock, at cost, 16,128 and 17,776 shares at September 30, 2001 and December 31, 2000, respectively..... | | | |
| Accumulated other comprehensive income..... | | | |
| Total equity..... | | | |
| Total liabilities and equity..... | | | \$ |

The accompanying notes are an integral part of these consolidated financial statements.

SPINNAKER EXPLORATION COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

| | For the Three Months Ended September 30, | | |
|---|---|-----------|----|
| | 2001 | 2000 | |
| REVENUES..... | \$ 44,818 | \$ 29,755 | \$ |
| EXPENSES: | | | |
| Lease operating expenses..... | 3,309 | 2,478 | |
| Depreciation, depletion and amortization - natural gas and oil properties..... | 23,009 | 11,989 | |
| Depreciation and amortization - other..... | 131 | 79 | |
| General and administrative..... | 2,219 | 1,853 | |

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| | | | |
|--|-----------|----------|----|
| Total expenses..... | 28,668 | 16,399 | |
| INCOME FROM OPERATIONS..... | 16,150 | 13,356 | |
| OTHER INCOME (EXPENSE): | | | |
| Interest income..... | 777 | 1,016 | |
| Interest expense, net..... | (48) | (377) | |
| Total other income (expense)..... | 729 | 639 | |
| INCOME BEFORE INCOME TAXES..... | 16,879 | 13,995 | |
| INCOME TAX PROVISION..... | 6,076 | 5,766 | |
| NET INCOME..... | \$ 10,803 | \$ 8,229 | \$ |
| NET INCOME PER COMMON SHARE: | | | |
| Basic..... | \$ 0.40 | \$ 0.35 | \$ |
| Diluted..... | \$ 0.38 | \$ 0.33 | \$ |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING: | | | |
| Basic..... | 27,172 | 23,414 | |
| Diluted..... | 28,335 | 24,917 | |

The accompanying notes are an integral part of these consolidated financial statements.

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SPINNAKER EXPLORATION COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

| | For Ende |
|---|-------------|
| | 2001 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Net income..... | \$ 60,7 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | |
| Depreciation, depletion and amortization..... | 63,6 |
| Deferred income tax expense..... | 34,1 |
| Other..... | (|
| Change in components of working capital: | |
| Accounts receivable..... | 15,9 |

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| | |
|---|---------|
| Accounts payable and accrued liabilities..... | 24,5 |
| Other current assets and other..... | 1,6 |
| | ----- |
| Net cash provided by operating activities..... | 200,6 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Oil and gas properties..... | (223,4 |
| Change in property related payables..... | (6,7 |
| Purchases of other property and equipment..... | (1,0 |
| Purchases of short-term investments..... | (29,6 |
| Sales of short-term investments..... | 49,0 |
| Proceeds from sale of natural gas and oil assets..... | |
| | ----- |
| Net cash used in investing activities..... | (211,7 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | |
| Proceeds from borrowings..... | |
| Payments on borrowings..... | |
| Proceeds from exercise of stock options..... | 6,1 |
| Proceeds from issuance of common stock..... | |
| Common stock issuance costs..... | |
| | ----- |
| Net cash provided by financing activities..... | 6,1 |
| | ----- |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS..... | (5,0 |
| CASH AND CASH EQUIVALENTS, beginning of year..... | 63,9 |
| | ----- |
| CASH AND CASH EQUIVALENTS, end of period..... | \$ 58,8 |
| | ===== |
| SUPPLEMENTAL CASH FLOW DISCLOSURES: | |
| Cash paid for interest, net of amounts capitalized..... | \$ 1 |
| Cash paid for income taxes..... | \$ |

The accompanying notes are an integral part of these consolidated financial statements.

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SPINNAKER EXPLORATION COMPANY
Notes to Interim Consolidated Financial Statements (Unaudited)
September 30, 2001

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Spinnaker Exploration Company ("Spinnaker" or the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting only of normal and recurring adjustments) necessary to present a fair statement of the results for the periods included herein have been made and the disclosures contained herein are adequate to make the information presented not misleading. Interim period results are not necessarily indicative of results of operations or cash flows for a full year. These consolidated financial statements and the notes thereto should be read in conjunction with the

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Company's Annual Report on Form 10-K for the year ended December 31, 2000.

2. Earnings Per Share

The basic and diluted net income per common share calculations are based on the following information (in thousands, except per share amounts):

| | Three Months Ended September 30, | |
|--|-------------------------------------|----------|
| | 2001 | 2000 |
| ----- | | |
| Numerator: | | |
| Net income..... | \$ 10,803 | \$ 8,229 |
| | ===== | ===== |
| Denominator: | | |
| Basic weighted average number of shares..... | 27,172 | 23,414 |
| | ===== | ===== |
| Dilutive securities: | | |
| Stock options..... | 1,163 | 1,503 |
| | ----- | ----- |
| Diluted adjusted weighted average number of shares and assumed conversions..... | 28,335 | 24,917 |
| | ===== | ===== |
| Net income per common share: | | |
| Basic..... | \$ 0.40 | \$ 0.35 |
| | ===== | ===== |
| Diluted..... | \$ 0.38 | \$ 0.33 |
| | ===== | ===== |

3. Credit Facility

On July 18, 2001, the Company renewed its existing \$75.0 million credit facility ("Credit Facility") on an unsecured basis for another 364-day term. The Company's borrowing base is currently set at a nominal \$30.0 million in order to minimize fees associated with this commitment and is redetermined periodically. The Credit Facility contains various financial covenants and restrictive provisions. At September 30, 2001, the Company had no outstanding borrowings under the Credit Facility.

4. Derivatives and Hedging

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 established accounting and reporting standards requiring that all derivative instruments be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in a derivative's fair value be realized currently in earnings unless specific hedge accounting criteria are met. Accounting for qualifying hedges allows derivative gains and losses to

offset related results on the hedged item in the income statement and requires a

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company to formally document, designate and assess the effectiveness of transactions that qualify for hedge accounting.

Upon adoption of SFAS No. 133 on January 1, 2001, the Company recorded (i) a net current liability of \$41.7 million, representing the fair market value of all derivatives on that date and (ii) a reduction of equity through accumulated other comprehensive income of \$27.1 million, representing the intrinsic and time value components of the derivatives as of January 1, 2001, net of income taxes of \$14.6 million.

Based upon the Company's assessment of its derivative contracts at September 30, 2001, it reported (i) a net current asset of \$20.3 million and a noncurrent asset of \$4.0 million and (ii) accumulated other comprehensive income of \$15.5 million, net of income taxes of \$8.5 million. The ineffective component of the derivatives recognized in earnings was \$0.3 million in the third quarter and the first nine months of 2001. In connection with monthly settlements, the Company recognized net hedging gains of \$2.5 million in the third quarter and net hedging losses of \$16.2 million in the first nine months of 2001 in revenues. Based on future natural gas prices as of September 30, 2001, \$20.3 million is expected to be reclassified to earnings within the next 12 months. The amounts ultimately reclassified into earnings will vary due to changes in the fair value of the open derivative contracts prior to settlement.

Historically, Spinnaker has utilized collar arrangements to reduce its exposure to fluctuations in natural gas and oil prices and achieve a more predictable cash flow for the volumes hedged. In August 2001, the Company effectively closed all of its open natural gas collar arrangements by entering into offsetting collars and simultaneously entered into natural gas swap contracts, where Spinnaker receives a fixed price. The Company used the net gains from closing its collar transactions to increase its weighted average swap prices. The Company also entered into additional fixed price swap contracts for the fourth quarter of 2001 and calendar year 2002 and an additional collar arrangement for October 2001. The Company's commodity price risk management positions on average daily volumes for the fourth quarter of 2001 and full year 2002 are as follows:

Natural Gas Swap Contracts

- . 103,207 MMBtus at a weighted average price of \$3.06 per MMBtu in the fourth quarter of 2001; and
- . 65,000 MMBtus at an average price of \$3.60 per MMBtu for the period January through December 2002.

Natural Gas Collar Arrangements

- . 15,000 MMBtus at a NYMEX floor price of \$3.00 per MMBtu and ceiling price of \$3.43 per MMBtu in October 2001.

In addition to the above collar, the Company had offsetting collar positions at September 30, 2001 for October and November production that have settled in the fourth quarter.

5. Comprehensive Income

Comprehensive income was \$28.3 million and \$87.2 million in the third quarter and the first nine months of 2001, respectively. Comprehensive income includes accumulated other comprehensive income of \$17.5 million and \$26.5 million related to derivatives and hedging activities in the third quarter and the first nine months of 2001, respectively.

6. New Accounting Principle

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In July 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." The statement requires entities to record the fair value of a liability for legal obligations associated with the retirement obligations of tangible long-lived assets in the period in which it is incurred. When the liability is initially recorded, the entity increases the carrying amount of the related long-lived asset. Over time, accretion of the liability is recognized each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. Spinnaker is currently evaluating the effect of adopting SFAS No. 143. The SFAS is effective for fiscal years beginning after June 15, 2002, with earlier application encouraged. The Company expects to adopt SFAS No. 143 effective January 1, 2003.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement About Forward-Looking Statements

Some of the information in this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The forward-looking statements speak only as of the date made, and the Company undertakes no obligation to update such forward-looking statements. These forward-looking statements may be identified by the use of the words "believe," "expect," "anticipate," "will," "contemplate," "would" and similar expressions that contemplate future events. These future events include the following matters:

- . financial position;
- . business strategy;
- . budgets;
- . amount, nature and timing of capital expenditures, including future development costs;
- . drilling of wells;
- . natural gas and oil reserves;
- . timing and amount of future production of natural gas and oil;
- . operating costs and other expenses;
- . cash flow and anticipated liquidity;
- . prospect development and property acquisitions; and
- . marketing of natural gas and oil.

Numerous important factors, risks and uncertainties may affect the Company's operating results, including:

- . the risks associated with exploration;
- . the ability to find, acquire, market, develop and produce new properties;
- . natural gas and oil price volatility;
- . uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures;
- . operating hazards attendant to the natural gas and oil business;
- . downhole drilling and completion risks that are generally not recoverable from third parties or insurance;
- . potential mechanical failure or under-performance of significant wells;
- . climatic conditions;
- . availability and cost of material and equipment;
- . delays in anticipated start-up dates;
- . actions or inactions of third-party operators of the Company's

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- properties;
- . the ability to find and retain skilled personnel;
- . availability of capital;
- . the strength and financial resources of competitors;
- . regulatory developments;
- . environmental risks; and
- . general economic conditions.

Any of the factors listed above and other factors contained in this Form 10-Q could cause the Company's actual results to differ materially from the results implied by these or any other forward-looking statements made by the Company or on its behalf. The Company cannot assure you that future results will meet expectations. You should pay particular attention to the risk factors and cautionary statements described in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

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General

Spinnaker is an independent energy company engaged in the exploration, development and production of natural gas and oil in the U.S. Gulf of Mexico. The Company's operating results depend substantially on the success of its exploratory drilling program and the prices of natural gas and oil. Revenues, profitability and future growth rates also substantially depend on factors beyond the Company's control, such as economic, political and regulatory developments and competition from other sources of energy. The energy markets historically have been very volatile, and natural gas and oil prices may fluctuate widely in the future. Sustained periods of low prices for natural gas and oil could materially and adversely affect the Company's financial position, its results of operations, the quantities of natural gas and oil reserves that it can economically produce and its access to capital.

Overview

Performance highlights for the three and nine months ended September 30, 2001 included the following:

Three Months Ended September 30, 2001 as Compared to the Three Months Ended September 30, 2000

- . Production of 14.2 billion cubic feet gas equivalent ("Bcfe"), up 77 percent;
- . Revenues of \$44.8 million, up 51 percent;
- . Income from operations of \$16.2 million, up 21 percent;
- . Net income of \$10.8 million, up 31 percent; and
- . Net cash flow from operations, before working capital changes, of \$39.2 million, up 50 percent.

Nine Months Ended September 30, 2001 as Compared to the Nine Months Ended September 30, 2000

- . Production of 40.2 Bcfe, up 113 percent;
- . Revenues of \$171.8 million, up 174 percent;
- . Income from operations of \$91.8 million, up 325 percent;
- . Net income of \$60.7 million, up 267 percent; and
- . Net cash flow from operations, before working capital changes, of \$158.5 million, up 204 percent.

Spinnaker's results of operations and financial position were significantly impacted by increased natural gas production and higher average natural gas

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prices in the first nine months of 2001 compared to the same period in 2000. Natural gas revenues increased \$113.8 million in the first nine months of 2001. Natural gas production volumes increased 20.8 Bcf, contributing \$106.5 million of the increase in natural gas revenues. This volume increase was primarily due to wells on seven new blocks which commenced production subsequent to the third quarter of 2000. Average natural gas price increases contributed \$7.3 million of the increase in natural gas revenues.

The Company had \$61.9 million in cash, cash equivalents and short-term investments at September 30, 2001. In addition, the Company had no debt at September 30, 2001.

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Results of Operations

The following table sets forth certain operating information with respect to the natural gas and oil operations of the Company:

| | Three Months Ended September 30, | | | |
|--|-------------------------------------|--|-----------|----|
| | 2001 | | 2000 | |
| Production: | | | | |
| Natural gas (MMcf)..... | 13,747 | | 7,729 | |
| Oil and condensate (MBbls)..... | 81 | | 50 | |
| Total (MMcfe)..... | 14,235 | | 8,029 | |
| Revenues (in thousands): | | | | |
| Natural gas..... | \$ 39,945 | | \$ 35,043 | \$ |
| Oil and condensate..... | 2,083 | | 1,475 | |
| Net hedging gains (losses)..... | 2,465 | | (6,763) | |
| Other..... | 325 | | - | |
| Total..... | \$ 44,818 | | \$ 29,755 | \$ |
| Average sales price per unit: | | | | |
| Natural gas revenues from production (per Mcf)..... | \$ 2.91 | | \$ 4.53 | \$ |
| Effects of hedging activities (per Mcf)..... | 0.17 | | (0.80) | |
| Average price (per Mcf)..... | \$ 3.08 | | \$ 3.73 | \$ |
| Oil and condensate revenues from production | | | | |
| (per Bbl)..... | \$ 25.66 | | \$ 29.61 | \$ |
| Effects of hedging activities (per Bbl)..... | - | | (11.65) | |
| Average price (per Bbl)..... | \$ 25.66 | | \$ 17.96 | \$ |
| Total revenues from production (per Mcfe)..... | \$ 2.95 | | \$ 4.55 | \$ |
| Effects of hedging activities (per Mcfe)..... | 0.18 | | (0.84) | |
| Total average price (per Mcfe)..... | \$ 3.13 | | \$ 3.71 | \$ |
| Expenses (per Mcfe): | | | | |
| Lease operating expenses..... | \$ 0.23 | | \$ 0.31 | \$ |
| Depreciation, depletion and amortization - natural gas and oil properties..... | 1.62 | | 1.49 | |

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| | | | | | |
|--|----|--------|----|--------|----|
| Income from operations (in thousands)..... | \$ | 16,150 | \$ | 13,356 | \$ |
|--|----|--------|----|--------|----|

Three Months Ended September 30, 2001 as Compared to the Three Months Ended September 30, 2000

Production increased approximately 6.2 Bcfe in the third quarter of 2001 compared to the third quarter of 2000. Average daily production was 155 million cubic feet gas equivalent ("MMcfe") compared to 87 MMcfe.

Revenues increased \$15.1 million in the third quarter of 2001 compared to the third quarter of 2000. Excluding the effects of hedging activities, natural gas revenues increased \$4.9 million and oil and condensate revenues increased \$0.6 million. Hedging activities improved revenues by \$9.6 million when compared to the third quarter of 2000.

Natural gas production volumes increased 6.0 Bcf, contributing \$26.2 million of the increase in natural gas revenues, excluding the effects of hedging activities, offset in part by \$21.3 million related to decreases in average natural gas prices in the third quarter of 2001 compared to the same period in 2000. Oil and condensate production volumes increased 31 thousand barrels ("MBbls"), contributing \$0.7 million of the increase in oil and condensate revenues, offset in part by \$0.1 million related to decreases in average oil and condensate prices. The natural gas and oil volume increases were primarily due to wells on six new blocks which commenced production subsequent to the third quarter of 2000.

Lease operating expenses increased \$0.8 million in the third quarter of 2001 compared to the third quarter of 2000. Of the total increase in lease operating expenses, \$0.5 million was attributable to wells on six new blocks which commenced production subsequent to the third quarter of 2000, and a net \$0.3 million was primarily related to increased workover activities in the third quarter of 2001. The lease operating expense rate decreased approximately 25% to \$0.23 per thousand

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cubic feet gas equivalent ("Mcfe") in the third quarter of 2001 compared to the same period in 2000 primarily due to continued efficiencies gained in core operating areas.

Depreciation, depletion and amortization ("DD&A") increased \$11.1 million in the third quarter of 2001 compared to the third quarter of 2000. The change in DD&A was attributable to an increase in production of 6.2 Bcfe and a higher DD&A rate, which impacted DD&A by \$9.3 million and \$1.8 million, respectively.

General and administrative expenses increased \$0.4 million in the third quarter of 2001 compared to the third quarter of 2000. The increase in general and administrative expenses was primarily due to employment-related costs associated with personnel additions subsequent to the third quarter of 2000.

The Company recognized net income of \$10.8 million, or \$0.40 per basic share and \$0.38 per diluted share, in the third quarter of 2001 compared to net income of \$8.2 million, or \$0.35 per basic share and \$0.33 per diluted share, in the third quarter of 2000.

Nine Months Ended September 30, 2001 as Compared to the Nine Months Ended September 30, 2000

Production increased approximately 21.3 Bcfe in the first nine months of 2001

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compared to the same period in 2000. Average daily production was 147 MMcfe compared to 69 MMcfe.

Revenues increased \$109.0 million in the first nine months of 2001 compared to the same period in 2000. Excluding the effects of hedging activities, natural gas revenues increased \$113.8 million and oil and condensate revenues increased \$1.9 million. Net hedging losses increased in the first nine months of 2001, reducing revenues by \$6.7 million.

Natural gas production volumes increased 20.8 Bcf, contributing \$106.5 million of the increase in natural gas revenues, excluding the effects of hedging activities, and an increase in average natural gas prices contributed \$7.3 million of the increase in natural gas revenues in the first nine months of 2001 compared to the same period in 2000. Oil and condensate production volumes increased 81 MBbls, contributing \$2.1 million of the increase in oil and condensate revenues, offset in part by \$0.2 million related to the decrease in average oil and condensate prices. The natural gas and oil volume increases were primarily due to wells on seven new blocks which commenced production subsequent to the third quarter of 2000.

Lease operating expenses increased \$3.0 million in the first nine months of 2001 compared to the same period in 2000. Of the total increase in lease operating expenses, \$1.5 million was attributable to wells on seven new blocks which commenced production subsequent to the third quarter of 2000, and a net \$1.5 million was primarily related to increased production in the first nine months of 2001 on existing blocks. The lease operating expense rate decreased approximately 31% to \$0.23 per Mcfe primarily due to continued efficiencies gained in core operating areas.

DD&A increased \$33.8 million in the first nine months of 2001 compared to the same period in 2000. The change in DD&A was primarily attributable to an increase in production of 21.3 Bcfe.

General and administrative expenses increased \$2.0 million in the first nine months of 2001 compared to the same period in 2000. The increase in general and administrative expenses was primarily due to increased employment-related costs associated with personnel additions subsequent to September 30, 2000, including increased payroll taxes associated with stock option exercises.

Interest income increased \$2.0 million in the first nine months of 2001 compared to the same period in 2000 primarily due to investment income associated with proceeds from the Company's public offering of common stock completed on August 16, 2000.

The Company recognized net income of \$60.7 million, or \$2.25 per basic share and \$2.14 per diluted share, in the first nine months of 2001 compared to net income of \$16.6 million, or \$0.77 per basic share and \$0.73 per diluted share, in the same period in 2000.

Liquidity and Capital Resources

The Company has experienced and expects to continue to experience substantial capital requirements, primarily due to its active exploration and development programs in the Gulf of Mexico. Capital expenditures in 1999, 2000 and the first nine months of 2001 were \$85.1 million, \$163.7 million and \$231.2 million, respectively. Spinnaker has capital expenditure plans

for 2001 totaling approximately \$275 million. While the Company believes that working capital, cash flows from operations and available borrowings under its

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\$75.0 million Credit Facility will be sufficient to meet its capital requirements through the end of 2001, additional financing may be required in the future to fund its growth and exploration and development programs. In the event additional capital resources are unavailable, the Company may curtail its drilling, development and other activities or be forced to sell some of its assets on an untimely or unfavorable basis.

Cash and cash equivalents decreased \$5.0 million to \$58.9 million at September 30, 2001 from \$63.9 million at December 31, 2000. The Company also has \$3.0 million of highly liquid investments in commercial paper that have maturity dates greater than three months. The decrease in cash and cash equivalents resulted from \$211.7 million used in investing activities, offset in part by \$200.6 million provided by operating activities and \$6.1 million provided by financing activities.

On October 26, 2001, Spinnaker filed a shelf registration statement with the Securities and Exchange Commission ("SEC") relating to the potential public offer and sale by the Company or its affiliates of up to \$300 million of any combination of debt securities, preferred stock, common stock, warrants, stock purchase contracts and trust preferred securities from time to time. The shelf registration statement has been declared effective by the SEC and allows Spinnaker to register the offer and sale of the securities in advance in order to provide the Company with the flexibility to sell the securities when market conditions are favorable or when financing needs arise.

The Company has a \$75.0 million Credit Facility with two banks that expires in July 2002. Spinnaker and the banks have agreed to a nominal \$30.0 million borrowing base in order to minimize fees associated with the commitment. The Company believes this borrowing base is adequate given the Company's cash and cash equivalents, short-term investments and cash flow from operations. Management believes that the borrowing base can be increased substantially based on current natural gas and oil reserves.

Operating Activities

Net cash of \$200.6 million was provided by operating activities in the first nine months of 2001, primarily as a result of increases in natural gas production and average prices. Cash flow from operations will depend on the Company's ability to increase production through its exploration and development programs and the prices of natural gas and oil. The Company has made significant investments to expand its operations in the Gulf of Mexico. These investments have resulted in an increase in the Company's daily production.

The Company sells its natural gas and oil production under fixed or floating market price contracts. From time to time, the Company enters into hedging arrangements to reduce its exposure to fluctuations in natural gas and oil prices and achieve a more predictable cash flow for volumes hedged. However, these contracts also limit the benefits the Company would realize if prices increase. See "Item 3. Quantitative and Qualitative Disclosures About Market Risk."

The Company's cash flow from operations also depends on its ability to manage working capital, including accounts receivable, accounts payable and accrued liabilities. The decrease in accounts receivable of \$16.0 million was primarily due to a decrease in accrued natural gas and oil revenues of \$20.2 million as a result of lower natural gas prices at September 30, 2001 compared to December 2000, partially offset by an increase in joint interest billings and other receivables of \$4.2 million due to higher activity levels associated with wells operated by the Company. The increases in accounts payable and accrued liabilities were primarily due to costs associated with increased drilling and development activities during the first nine months of 2001 compared to the end of 2000.

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Investing Activities

Net cash of \$211.7 million used in investing activities in the first nine months of 2001 included net oil and gas property capital expenditures of \$230.1 million and purchases of other property and equipment of \$1.0 million. The Company also purchased short-term investments of \$29.6 million and sold short-term investments of \$49.0 million.

The Company drilled 25 exploratory wells in the first nine months of 2001, 15 of which were successful. In 2000, the Company drilled 28 exploratory wells, 16 of which were successful. Since inception and through September 30, 2001, the Company has drilled 84 exploratory wells, 52 of which were successful, representing a success rate of approximately 62%.

The Company has capital expenditure plans for 2001 totaling approximately \$275 million, primarily for costs related to exploration and development programs. The 2001 budget includes development costs that are contingent on the success of exploratory drilling. Spinnaker does not anticipate that budgeted leasehold acquisition activities will include the acquisition of producing properties. The Company does not anticipate any significant abandonment or dismantlement costs in 2001. Actual

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levels of capital expenditures may vary due to many factors, including drilling results, natural gas and oil prices, the availability of capital, industry conditions, decisions of operators and other prospect owners and the prices of drilling rig day rates and other oilfield goods and services.

Financing Activities

Net cash of \$6.1 million was provided by financing activities in the first nine months of 2001. These proceeds related to stock option exercises.

On July 18, 2001, the Company renewed its existing \$75.0 million Credit Facility on an unsecured basis for another 364-day term. The Company's borrowing base is currently set at a nominal \$30.0 million in order to minimize fees associated with this commitment and is redetermined periodically. The Company has the option to elect to use a base interest rate as described below or the LIBOR rate plus, for each such rate, a spread based on the percent of the borrowing base used at that time. The base interest rate under the Credit Facility is a fluctuating rate of interest equal to the higher of either the Toronto-Dominion Bank's base rate for dollar advances made in the United States or the Federal Funds Rate plus 0.5 percent per annum. The Credit Facility contains various financial covenants and restrictive provisions. At September 30, 2001, the Company was in compliance with the covenants and had no outstanding borrowings under the Credit Facility.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

The Company is exposed to changes in interest rates. Changes in interest rates affect the interest earned on the Company's cash, cash equivalents and short-term investments and the interest rate paid on borrowings under the Credit Facility. Under its current policies, the Company does not use interest rate derivative instruments to manage exposure to interest rate changes.

Commodity Price Risk

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The Company's revenues, profitability and future growth depend substantially on prevailing prices for natural gas and oil. Prices also affect the amount of cash flow available for capital expenditures and the Company's ability to borrow and raise additional capital. Lower prices may also reduce the amount of natural gas and oil that the Company can economically produce. The Company sells its natural gas and oil production under fixed or floating market price contracts. Spinnaker enters into hedging arrangements to reduce its exposure to fluctuations in natural gas and oil prices and to achieve more predictable cash flow. However, these contracts also limit the benefits the Company would realize if prices increase. These financial arrangements take the form of natural gas swap contracts or costless collars and are placed with major financial institutions the Company believes represent minimum credit risks. Under its current hedging practice, the Company does not hedge more than 50 percent of its production quantities without the prior approval of the risk management committee.

Historically, Spinnaker has utilized collar arrangements to reduce its exposure to fluctuations in natural gas and oil prices and achieve a more predictable cash flow for the volumes hedged. In August 2001, the Company effectively closed all of its open natural gas collar arrangements by entering into offsetting collars and simultaneously entered into natural gas swap contracts, where Spinnaker receives a fixed price. The Company used the net gains from closing its collar transactions to increase its weighted average swap prices. The Company also entered into additional fixed price swap contracts for the fourth quarter of 2001 and calendar year 2002 and an additional collar arrangement for October 2001.

The Company's swap contracts will settle based on the reported settlement price on the NYMEX for the last trading day of each month for natural gas. In a swap transaction, the counterparty is required to make a payment to the Company for the difference between the fixed price and the settlement price if the settlement price is below the fixed price. The Company is required to make a payment to the counterparty for the difference between the fixed price and the settlement price if the settlement price is above the fixed price.

The Company's commodity price risk management positions on average daily volumes for the fourth quarter of 2001 and full year 2002 are as follows:

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Natural Gas Swap Contracts

- . 103,207 MMBtus at a weighted average price of \$3.06 per MMBtu in the fourth quarter of 2001; and
- . 65,000 MMBtus at an average price of \$3.60 per MMBtu for the period January through December 2002.

Natural Gas Collar Arrangements

- . 15,000 MMBtus at a NYMEX floor price of \$3.00 per MMBtu and ceiling price of \$3.43 per MMBtu in October 2001.

In addition to the above collar, the Company had offsetting collar positions at September 30, 2001 for October and November production that have settled in the fourth quarter.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 established accounting and reporting standards requiring that all derivative instruments be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in a derivative's fair value be realized currently

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in earnings unless specific hedge accounting criteria are met. Accounting for qualifying hedges allows derivative gains and losses to offset related results on the hedged item in the income statement and requires a company to formally document, designate and assess the effectiveness of transactions that qualify for hedge accounting.

Upon adoption of SFAS No. 133 on January 1, 2001, the Company recorded (i) a net current liability of \$41.7 million, representing the fair market value of all derivatives on that date and (ii) a reduction of equity through accumulated other comprehensive income of \$27.1 million, representing the intrinsic and time value components of the derivatives as of January 1, 2001, net of income taxes of \$14.6 million.

Based upon the Company's assessment of its derivative contracts at September 30, 2001, it reported (i) a net current asset of \$20.3 million and a noncurrent asset of \$4.0 million and (ii) accumulated other comprehensive income of \$15.5 million, net of income taxes of \$8.5 million. The ineffective component of the derivatives recognized in earnings was \$0.3 million in the third quarter and the first nine months of 2001. In connection with monthly settlements, the Company recognized net hedging gains of \$2.5 million in the third quarter and net hedging losses of \$16.2 million in the first nine months of 2001 in revenues. Based on future natural gas prices as of September 30, 2001, \$20.3 million is expected to be reclassified to earnings within the next 12 months. The amounts ultimately reclassified into earnings will vary due to changes in the fair value of the open derivative contracts prior to settlement.

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PART II - OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

12.1 - Calculation of Ratios of Earnings to Fixed Charges and Combined Fixed Charges and Preferred Dividends

(b) Reports on Form 8-K

- 1) A Current Report on Form 8-K dated August 14, 2001 and filed on August 24, 2001 reported an update of the Company's commodity price risk management positions.
- 2) A Current Report on Form 8-K dated September 12, 2001 and filed on September 21, 2001 reported an update of the Company's commodity price risk management positions.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SPINNAKER EXPLORATION COMPANY

Date: November 8, 2001

By: /s/ ROBERT M. SNELL

Robert M. Snell

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Vice President, Chief Financial
Officer and Secretary

Date: November 8, 2001

By: /s/ JEFFREY C. ZARUBA

Jeffrey C. Zaruba
Vice President, Treasurer and
Assistant Secretary

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EXHIBIT INDEX

| Exhibit Number ----- | Description ----- |
|----------------------------|--|
| 12.1 - | Calculation of Ratios of Earnings to Fixed Charges and Combined Fixed Charges and Preferred Dividends |

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