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SPINNAKER EXPLORATION CO
Form 10-Q
May 10, 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 March 31, 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 May 9, 2001 was 27,138,707.

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SPINNAKER EXPLORATION COMPANY
FORM 10-Q
FOR THE THREE MONTHS ENDED MARCH 31, 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..... | |
| Deferred taxes..... | |
| 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..... | |

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| | |
|--|--|
| Total property and equipment..... | |
| OTHER ASSETS..... | |
| Total assets..... | |
| LIABILITIES AND EQUITY | |
| CURRENT LIABILITIES: | |
| Accounts payable..... | |
| Accrued liabilities..... | |
| Hedging 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 March 31, 2001 and December 31, 2000..... | |
| Common stock, \$0.01 par value; 50,000,000 shares authorized; 27,115,454 shares issued and 27,098,222 shares outstanding at March 31, 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, 17,232 and 17,776 shares at March 31, 2001 and December 31, 2000, respectively..... | |
| Accumulated other comprehensive income (loss)..... | |
| 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)

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| | |
|--|--------|
| REVENUES..... | \$67,4 |
| EXPENSES: | |
| Lease operating expenses..... | 2,6 |
| Depreciation, depletion and amortization - natural gas and oil properties..... | 19,3 |
| Depreciation and amortization - other..... | |
| General and administrative..... | 2,5 |
| | ----- |
| Total expenses..... | 24,6 |
| | ----- |
| INCOME FROM OPERATIONS..... | 42,7 |
| OTHER INCOME (EXPENSE): | |
| Interest income..... | 1,3 |
| Interest expense..... | (1) |
| | ----- |
| Total other income (expense)..... | 1,1 |
| | ----- |
| INCOME BEFORE INCOME TAXES..... | 43,9 |
| INCOME TAX PROVISION..... | 15,8 |
| | ----- |
| NET INCOME..... | \$28,1 |
| | ===== |
| NET INCOME PER COMMON SHARE: | |
| Basic..... | \$1. |
| | ===== |
| Diluted..... | \$1. |
| | ===== |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING: | |
| Basic..... | 26,7 |
| | ===== |
| Diluted..... | 28,1 |
| | ===== |

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

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

| | |
|---|---------|
| | ----- |
| | 2001 |
| | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Net income..... | \$ 28,1 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | |
| Depreciation, depletion and amortization..... | 19,4 |
| Deferred income tax expense..... | 15,8 |
| Other..... | (3) |

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| | |
|---|---------|
| Change in components of working capital: | |
| Accounts receivable..... | 6,6 |
| Accounts payable and accrued liabilities..... | 15,7 |
| Other current assets and other..... | (2,1) |
| | ----- |
| Net cash provided by operating activities..... | 83,3 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Oil and gas properties..... | (52,0) |
| Change in property related payables..... | (7,0) |
| Purchases of other property and equipment..... | (3 |
| Purchases of short-term investments..... | (26,6 |
| | ----- |
| Net cash used in investing activities..... | (86,0 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | |
| Proceeds from exercise of stock options..... | 5,4 |
| | ----- |
| Net cash provided by financing activities..... | 5,4 |
| | ----- |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS..... | 2,7 |
| CASH AND CASH EQUIVALENTS, beginning of year..... | 63,9 |
| | ----- |
| CASH AND CASH EQUIVALENTS, end of period..... | \$ 66,6 |
| | ===== |
| SUPPLEMENTAL CASH FLOW DISCLOSURES: | |
| Cash paid for interest, net of amounts capitalized..... | \$ |
| 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)
MARCH 31, 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 Company's Annual Report on Form 10-K for the year ended December 31, 2000.

2. EARNINGS PER SHARE

Basic and diluted net income per share is computed based on the following

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information (in thousands, except per share amounts):

| | FOR THE THREE MONTHS ENDED MARCH 31, | |
|---|---|----------|
| | 2001 | |
| Numerator: | | |
| Net income..... | \$28,148 ===== | \$ == |
| Denominator: | | |
| Basic weighted average number of shares..... | 26,772 ===== | 2 == |
| Dilutive securities: | | |
| Stock options..... | 1,424 ----- | -- -- |
| Diluted adjusted weighted average number of shares and assumed conversions..... | 28,196 ===== | 2 == |
| Net income per common share: | | |
| Basic..... | \$ 1.05 ===== | \$ == |
| Diluted..... | \$ 1.00 ===== | \$ == |

3. NEW ACCOUNTING PRINCIPLE

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 recognized 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 company to formally document, designate and assess the effectiveness of transactions that qualify for hedge accounting. The Company adopted SFAS No. 133 on January 1, 2001.

The Company currently utilizes collar arrangements to reduce its exposure to fluctuations in natural gas and oil prices and to achieve a more predictable cash flow. Based upon the Company's assessment of its derivative contracts at January 1, 2001, it 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. The current liability is adjusted monthly to reflect the current fair market value, and the monthly settlement is recorded to revenues with related adjustments to accumulated other comprehensive income.

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Based upon the Company's assessment of its derivative contracts at March 31, 2001, it reported (i) a net current liability of \$9.7 million and (ii) a reduction of equity through accumulated other comprehensive income of \$6.7 million, net of income taxes of \$3.4 million. The change in the time value component of the derivatives of \$0.4 million was recorded in revenues in the first quarter of 2001.

The Company recognized net hedging losses of \$16.6 million in the first quarter of 2001 compared to net hedging income of \$0.5 million in the same period in 2000. Comprehensive income was \$31.9 million in the first quarter of 2001.

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

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. 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 price 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

Since its inception in December 1996, Spinnaker recorded its best results ever in the first quarter of 2001. Performance highlights compared to results in the first quarter of 2000 included record:

- . Production of 12.4 billion cubic feet equivalent ("Bcfe"), up 153 percent.
- . Income from operations of \$42.8 million, up from \$2.9 million.
- . Net income of \$28.1 million, or \$1.00 per diluted share, up from \$3.1 million, or \$0.15 per diluted share.
- . Cash flow from operating activities, before working capital changes, of \$63.1 million, up 477 percent.

Spinnaker's results of operations and financial position were significantly impacted by increased natural gas production and prices in the first quarter of 2001. Natural gas revenues increased \$69.7 million and natural gas production volumes increased 7.4 Bcf, primarily due to wells on eight new blocks which commenced production subsequent to the first quarter of 2000, contributing \$56.6 million of the increase in natural gas revenues. Average natural gas price increases contributed \$13.1 million of the increase in natural gas revenues.

The Company had \$115.7 million in cash, cash equivalents and short-term investments at March 31, 2001. In addition, the Company had no debt at March 31, 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:

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| | FOR THE THREE MONTHS ENDED MARCH 31, | |
|---|---|------------------|
| | 2001 | 2000 |
| PRODUCTION: | | |
| Natural gas (MMcfe)..... | 11,969 | 4 |
| Oil and condensate (MBbls)..... | 77 | 1 |
| Total (MMcfe)..... | 12,430 | 4 |
| REVENUES (IN THOUSANDS): | | |
| Natural gas..... | \$ 81,455 | \$ 11,455 |
| Oil and condensate..... | 2,163 | 1,163 |
| Net hedging income (loss)..... | (16,600) | (16,600) |
| Other..... | 435 | 435 |
| | ----- | ----- |
| Total..... | \$ 67,453 | \$ 13,453 |
| AVERAGE SALES PRICE PER UNIT: | | |
| Natural gas revenues from production (per Mcf)..... | \$ 6.81 | \$ 6.81 |
| Effects of hedging activities (per Mcf)..... | (1.39) | (1.39) |
| | ----- | ----- |
| Average price (per Mcf)..... | \$ 5.42 | \$ 5.42 |
| Oil and condensate revenues from production (per Bbl)..... | \$ 28.18 | \$ 28.18 |
| Effects of hedging activities (per Bbl)..... | - | - |
| | ----- | ----- |
| Average price (per Bbl)..... | \$ 28.18 | \$ 28.18 |
| Total revenues from production (per Mcfe)..... | \$ 6.73 | \$ 6.73 |
| Effects of hedging activities (per Mcfe)..... | (1.34) | (1.34) |
| | ----- | ----- |
| Total average price (per Mcfe)..... | \$ 5.39 | \$ 5.39 |
| EXPENSES (PER MCFE): | | |
| Lease operating expenses..... | \$ 0.22 | \$ 0.22 |
| Depreciation, depletion and amortization - natural gas and oil properties..... | \$ 1.56 | \$ 1.56 |
| INCOME FROM OPERATIONS (IN THOUSANDS)..... | \$ 42,792 | \$ 42,792 |

Three Months Ended March 31, 2001 as Compared to the Three Months Ended
March 31, 2000

Production increased approximately 7.5 Bcfe in the first quarter of 2001 compared to the first quarter of 2000. The daily production rate at the end of March 2001 was approximately 150 million cubic feet equivalent ("MMcfe") compared to approximately 130 MMcfe at the end of December 2000.

Revenues increased \$53.6 million and income from operations increased \$39.9 million in the first quarter of 2001 compared to the first quarter of 2000. Excluding the effects of hedging activities, natural gas revenues increased \$69.7 million and oil and condensate revenues increased \$0.5 million in the first quarter of 2001 compared to the same period in 2000. Net losses associated

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with natural gas and oil hedging activities increased \$16.6 million in the first quarter of 2001 compared to the same period in 2000.

Natural gas production volumes increased 7.4 Bcf, primarily due to wells on eight new blocks which commenced production subsequent to the first quarter of 2000, contributing \$56.6 million of the increase in natural gas revenues, excluding the effects of hedging activities. Average natural gas price increases contributed \$13.1 million of the increase in natural gas revenues. Oil and condensate production volumes increased approximately 19 thousand barrels ("MBbls"), primarily due to wells on eight new blocks which commenced production subsequent to the first quarter of

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2000, contributing \$0.5 million of the increase in oil and condensate revenues. Average oil and condensate prices increased slightly in the first quarter of 2001 compared to the same period in 2000.

Lease operating expenses increased \$1.1 million in the first quarter of 2001 compared to the first quarter of 2000. Of the total increase in lease operating expenses, \$1.9 million was attributable to wells on eight new blocks which commenced production subsequent to the first quarter of 2000, offset in part by \$0.8 million primarily related to lower production activity on two wells and recompletion activities on another well in the first quarter of 2001 compared to the same period in 2000.

Depreciation, depletion and amortization ("DD&A") increased \$11.6 million in the first quarter of 2001 compared to the first quarter of 2000. The increase in DD&A was primarily attributable to the 7.5 Bcfe increase in production volumes in the first quarter of 2001, contributing \$11.9 million of the increase in DD&A, offset in part by \$0.3 million related to a decrease in the DD&A rate.

General and administrative expenses increased \$1.0 million in the first quarter of 2001 compared to the first quarter of 2000. The increase in general and administrative expenses was primarily due to increased employment-related costs of approximately \$0.5 million associated with personnel additions subsequent to the first quarter of 2000 and increased payroll taxes of \$0.3 million associated with stock option exercises during the first quarter of 2001.

Interest income increased \$1.1 million in the first quarter of 2001 compared to the first quarter of 2000 primarily due to investment income associated with proceeds from the Company's public offering of Common Stock completed on August 16, 2000. Interest expense increased \$0.1 million in the first quarter of 2001 compared to the same period in 2000 primarily due to higher debt financing costs and commitment fees. At March 31, 2001, the Company had no outstanding borrowings.

An income tax provision of \$15.8 million was recorded in the first quarter of 2001. No income tax provision was recorded in the first quarter of 2000 due to the availability of net operating loss carryforwards not previously benefited that offset estimated taxable income in 2000.

The Company recognized net income of \$28.1 million, or \$1.05 per basic share and \$1.00 per diluted share in the first quarter of 2001 compared to net income of \$3.1 million, or \$0.15 per basic and diluted share in the first quarter of 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

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programs in the Gulf of Mexico. Capital expenditures in 1999, 2000 and the first quarter of 2001 were \$85.1 million, \$163.7 million and \$59.4 million respectively. The Company has capital expenditure plans for 2001 totaling approximately \$260 million. While the Company believes that working capital, cash flows from operations and borrowings under its \$75.0 million credit facility ("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 increased \$2.7 million to \$66.6 million at March 31, 2001 from \$63.9 million at December 31, 2000. The Company also has \$49.0 million of highly liquid investments in commercial paper that have maturity dates greater than three months. The increase in cash and cash equivalents resulted from \$83.3 million provided by operating activities and \$5.5 million provided by financing activities, offset in part by \$86.1 million used in investing activities.

The Company has a \$75.0 million Credit Facility with two banks that expires in July 2001. 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, 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 and current commodity prices.

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OPERATING ACTIVITIES

The Company intends to use cash, short-term investments and cash flows from operations to fund a portion of its future lease acquisition, exploration and development activities. Net cash of \$83.3 million was provided by operating activities in the first quarter of 2001, primarily as a result of increases in natural gas production and 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 to approximately 150 MMcfe at the end of March 2001 from approximately 130 MMcfe at the end of December 2000. The Company expects higher production and cash flow during the remainder of 2001 as recent discoveries commence production. However, the Company can provide no assurance that production volumes and pricing in 2001 will achieve expectations.

The Company currently sells most of its natural gas and oil production under price sensitive or market price contracts. To reduce exposure to fluctuations in natural gas and oil prices, the Company enters into hedging arrangements. 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 \$6.6 million was primarily due to a decrease in accrued natural gas and oil revenues of \$8.9 million largely as a result of a decrease in natural gas prices since December 2000, partially offset by an increase in joint interest billings and other receivables of \$2.3 million due to higher activity levels associated with wells operated by

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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 quarter of 2001 compared to the end of 2000.

INVESTING ACTIVITIES

Net cash of \$86.1 million used in investing activities in the first quarter of 2001 included net oil and gas property capital expenditures of \$59.1 million and purchases of other property and equipment of \$0.3 million. The Company also purchased short-term investments of \$26.7 million.

The Company drilled nine exploratory wells in the first quarter of 2001, five of which were successful. In 2000, the Company drilled 28 exploratory wells, 16 of which were successful. Since inception, the Company has drilled 68 exploratory wells, 42 of which were successful, representing a success rate of approximately 62%.

The 2001 budget includes development costs that are contingent on the success of future exploratory drilling. The Company 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. The Company has capital expenditure plans for 2001 totaling approximately \$260 million, primarily for costs related to exploration and development programs. Actual levels of capital expenditures may vary significantly 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 dayrates and other oilfield goods and services.

FINANCING ACTIVITIES

Net cash of \$5.5 million was provided by financing activities in the first quarter of 2001. These proceeds related to stock option exercises.

The Company is currently a party to the \$75.0 million Credit Facility with an original term of 364 days. The borrowing base as of March 31, 2001 was \$30.0 million. At March 31, 2001, the Company had no outstanding borrowings under the Credit Facility. The Credit Facility is secured by substantially all of the Company's assets, including its interests in natural gas and oil properties. 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.

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The Credit Facility contains various covenants and restrictive provisions. It also requires the Company to maintain certain financial covenants, including the ratio of consolidated current assets to consolidated current liabilities, other than debt and hedging-related liabilities, as of the end of each fiscal quarter so that it is not less than 1.00 to 1.00 and the ratio of EBITDAX, as defined, to consolidated interest expense so that it is not less than 5.0 to 1.0 for any period of four consecutive fiscal quarters.

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

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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

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 currently sells most of its natural gas and oil production under price sensitive or market price contracts. To reduce exposure to fluctuations in natural gas and oil prices and to achieve more predictable cash flow, the Company entered into hedging arrangements beginning in the fourth quarter of 1999. However, these contracts also limit the benefits the Company would realize if prices increase. These financial arrangements take the form of 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. The daily production rates at the end of March 2001 were approximately 144.5 MMcf of natural gas and approximately 850 barrels of oil and condensate. The Company has entered into the following natural gas collar arrangements (one MMBtu approximates one Mcf of gas):

| Time Period | Average Daily Volume (MMBtu) | Pri |
|--|---------------------------------------|-----|
| Second Quarter 2001..... | 53,297 | |
| Third Quarter 2001..... | 50,000 | |
| Fourth Quarter 2001 (through November 30, 2001)..... | 50,000 | |

The Company's open collar arrangements will settle based on the reported settlement price on the NYMEX for the last trading day each month for natural gas. In a collar transaction, the counterparty is required to make a payment to the Company if the settlement price for any settlement period is below the floor price for the transaction, and the Company is required to make a payment to the counterparty if the settlement price for any settlement period is above the ceiling price for the transaction. The Company recognizes gains and losses in revenues when the related production occurs. The Company recognized net hedging losses of \$16.6 million in the first quarter of 2001.

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 recognized 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 company to formally document, designate and assess the effectiveness of transactions that qualify for hedge accounting. The Company adopted SFAS No. 133 on January 1, 2001.

Based upon the Company's assessment of its derivative contracts at January 1, 2001, it 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. The current liability is adjusted monthly to reflect the current fair market value, and the monthly settlement is recorded to revenues with related adjustments to accumulated other comprehensive income.

Based upon the Company's assessment of its derivative contracts at March 31, 2001, it reported (i) a net current liability of \$9.7 million and (ii) a reduction of equity through accumulated other comprehensive income of \$6.7 million, net of income taxes of \$3.4 million. The change in the time value component of the derivatives of \$0.4 million was recorded in revenues in the first quarter of 2001.

The Company recognized net hedging losses of \$16.6 million in the first quarter of 2001 compared to net hedging income of \$0.5 million in the same period in 2000.

PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

None.

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: May 10, 2001

By: /s/ ROBERT M. SNELL

Robert M. Snell
Vice President, Chief Financial
Officer and Secretary

Date: May 10, 2001

By: /s/ JEFFREY C. ZARUBA

Jeffrey C. Zaruba
Vice President, Treasurer and

