

CABOT OIL & GAS CORP
Form 10-Q
July 27, 2012
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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 June 30, 2012

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

Commission file number 1-10447

CABOT OIL & GAS CORPORATION

(Exact name of registrant as specified in its charter)

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DELAWARE
(State or other jurisdiction of
incorporation or organization)

04-3072771
(I.R.S. Employer
Identification Number)

Three Memorial City Plaza
840 Gessner Road, Suite 1400, Houston, Texas 77024
(Address of principal executive offices including ZIP code)

(281) 589-4600
(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 and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ 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 ☒ 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

As of July 23, 2012, there were 209,988,641 shares of Common Stock, Par Value \$.10 Per Share, outstanding.

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CABOT OIL & GAS CORPORATION

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****CABOT OIL & GAS CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEET (Unaudited)**

(In thousands, except share amounts)	June 30, 2012	December 31, 2011
ASSETS		
Current Assets		
Cash and Cash Equivalents	\$ 48,641	\$ 29,911
Accounts Receivable, Net	89,167	114,381
Income Taxes Receivable		1,388
Inventories	11,985	21,278
Derivative Instruments	139,346	174,263
Other Current Assets	6,728	4,579
Total Current Assets	295,867	345,800
Properties and Equipment, Net (Successful Efforts Method)	4,061,674	3,934,584
Derivative Instruments	18,759	21,249
Other Assets	33,892	29,860
	\$ 4,410,192	\$ 4,331,493
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts Payable	\$ 237,417	\$ 217,294
Income Taxes Payable	3,387	
Deferred Income Taxes	45,939	55,132
Accrued Liabilities	54,116	70,918
Total Current Liabilities	340,859	343,344
Postretirement Benefits	40,474	38,708
Long-Term Debt	972,000	950,000
Deferred Income Taxes	829,027	802,592
Asset Retirement Obligation	61,952	60,142
Other Liabilities	34,550	31,939
Total Liabilities	2,278,862	2,226,725
Commitments and Contingencies		
Stockholders' Equity		
Common Stock:		
Authorized 480,000,000 Shares of \$0.10 Par Value in 2012 and 240,000,000 Shares of \$0.10 Par Value in 2011		
Issued 209,975,716 Shares and 209,019,458 Shares in 2012 and 2011, respectively	20,998	20,902
Additional Paid-in Capital	720,670	724,377

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Retained Earnings	1,304,178	1,258,291
Accumulated Other Comprehensive Income	88,833	104,547
Less Treasury Stock, at Cost:		
404,400 Shares in 2012 and 2011, respectively	(3,349)	(3,349)
Total Stockholders' Equity	2,131,330	2,104,768
	\$ 4,410,192	\$ 4,331,493

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

Table of Contents**CABOT OIL & GAS CORPORATION****CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)**

(In thousands, except per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
OPERATING REVENUES				
Natural Gas	\$ 201,051	\$ 200,357	\$ 407,833	\$ 370,455
Brokered Natural Gas	5,149	11,072	18,593	29,480
Crude Oil and Condensate	57,466	28,042	107,447	46,634
Other	1,991	1,225	3,920	3,153
	265,657	240,696	537,793	449,722
OPERATING EXPENSES				
Brokered Natural Gas Cost	4,250	9,796	16,122	25,158
Direct Operations	29,306	22,579	56,626	49,586
Transportation and Gathering	33,139	16,074	63,397	28,942
Taxes Other Than Income	10,854	5,877	29,437	14,028
Exploration	16,244	4,592	20,245	10,900
Depreciation, Depletion and Amortization	114,616	83,225	224,973	160,349
General and Administrative	46,872	26,006	69,421	50,305
	255,281	168,149	480,221	339,268
Gain / (Loss) on Sale of Assets	67,703	34,071	67,168	32,554
INCOME FROM OPERATIONS	78,079	106,618	124,740	143,008
Interest Expense and Other	18,495	18,044	35,412	35,411
Income Before Income Taxes	59,584	88,574	89,328	107,597
Income Tax Expense	23,647	33,897	35,073	40,034
NET INCOME	\$ 35,937	\$ 54,677	\$ 54,255	\$ 67,563
Earnings Per Share				
Basic	\$ 0.17	\$ 0.26	\$ 0.26	\$ 0.32
Diluted	\$ 0.17	\$ 0.26	\$ 0.26	\$ 0.32
Weighted-Average Shares Outstanding				
Basic	209,512	208,528	209,320	208,408
Diluted	211,158	210,674	210,974	210,176
Dividends per common share	\$ 0.02	\$ 0.02	\$ 0.04	\$ 0.03

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

Table of Contents**CABOT OIL & GAS CORPORATION****CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (Unaudited)**

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net Income	\$ 35,937	\$ 54,677	\$ 54,255	\$ 67,563
Other Comprehensive Income / (Loss), net of taxes:				
Reclassification Adjustment for Settled Contracts (1)	(44,579)	(8,155)	(78,649)	(16,326)
Changes in Fair Value of Hedge Positions (2)	11,246	29,983	54,451	37,778
Defined Benefit Pension and Postretirement Plans:				
Amortization of Net Obligation at Transition (3)		99		198
Amortization of Prior Service Cost (4)	67	199	135	398
Amortization of Net Loss (5)	4,174	2,009	8,349	4,018
Foreign Currency Translation Adjustment (6)		(6)		(8)
Total Other Comprehensive Income / (Loss)	(29,092)	24,129	(15,714)	26,058
Comprehensive Income / (Loss)	\$ 6,845	\$ 78,806	\$ 38,541	\$ 93,621

(1) Net of income taxes of \$28,263 and \$4,998 for the three months ended June 30, 2012 and 2011, respectively, and \$49,863 and \$10,006 for the six months ended June 30, 2012 and 2011, respectively.

(2) Net of income taxes of \$(7,130) and \$(18,331) for the three months ended June 30, 2012 and 2011, respectively, and \$(34,653) and \$(23,109) for the six months ended June 30, 2012 and 2011, respectively.

(3) Net of income taxes of \$0 and \$(59) for the three months ended June 30, 2012 and 2011, respectively, and \$0 and \$(118) for the six months ended June 30, 2012 and 2011, respectively.

(4) Net of income taxes of \$(43) and \$(117) for the three months ended June 30, 2012 and 2011, respectively and \$(86) and \$(235) for the six months ended June 30, 2012 and 2011, respectively.

(5) Net of income taxes of \$(2,647) and \$(1,194) for the three months ended June 30, 2012 and 2011, respectively and \$(5,294) and \$(2,388) for the six months ended June 30, 2012 and 2011, respectively.

(6) Net of income taxes of \$0 and \$3 for the three months ended June 30, 2012 and 2011, respectively and \$0 and \$3 for the six months ended June 30, 2012 and 2011, respectively.

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

Table of Contents**CABOT OIL & GAS CORPORATION****CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)**

(In thousands)	Six Months Ended June 30,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$ 54,255	\$ 67,563
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities:		
Depreciation, Depletion and Amortization	224,973	160,349
Deferred Income Tax Expense	27,073	36,886
(Gain) / Loss on Sale of Assets	(67,168)	(32,554)
Exploration Expense	10,925	504
Unrealized (Gain) / Loss on Derivative Instruments	300	886
Amortization of Debt Issuance Costs	3,334	2,253
Stock-Based Compensation, Pension and Other	26,987	26,932
Changes in Assets and Liabilities:		
Accounts Receivable, Net	25,214	(22,826)
Income Taxes	4,775	(33,850)
Inventories	9,293	5,623
Other Current Assets	(3,691)	(1,208)
Accounts Payable and Accrued Liabilities	(28,675)	10,821
Other Assets and Liabilities	3,547	(678)
Net Cash Provided by Operating Activities	291,142	220,701
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital Expenditures	(411,327)	(404,214)
Proceeds from Sale of Assets	132,715	54,336
Investment in Equity Method Investment	(2,088)	
Net Cash Used in Investing Activities	(280,700)	(349,878)
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings from Debt	170,000	220,000
Repayments of Debt	(148,000)	(100,000)
Dividends Paid	(8,368)	(6,250)
Capitalized Debt Issuance Costs	(5,005)	(1,025)
Other	(339)	(183)
Net Cash Provided by Financing Activities	8,288	112,542
Net Increase / (Decrease) in Cash and Cash Equivalents	18,730	(16,635)
Cash and Cash Equivalents, Beginning of Period	29,911	55,949
Cash and Cash Equivalents, End of Period	\$ 48,641	\$ 39,314

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

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CABOT OIL & GAS CORPORATION

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. FINANCIAL STATEMENT PRESENTATION

During interim periods, Cabot Oil & Gas Corporation (the Company) follows the same accounting policies disclosed in its Annual Report on Form 10-K for the year ended December 31, 2011 (Form 10-K) filed with the Securities and Exchange Commission (SEC). The interim financial statements should be read in conjunction with the notes to the consolidated financial statements and information presented in the Form 10-K. In management's opinion, the accompanying interim condensed consolidated financial statements contain all material adjustments, consisting only of normal recurring adjustments, necessary for a fair statement. The results for any interim period are not necessarily indicative of the expected results for the entire year.

Certain reclassifications have been made to prior year statements to conform with current year presentation. These reclassifications have no impact on previously reported net income.

On January 3, 2012, the Board of Directors declared a 2-for-1 split of the Company's common stock in the form of a stock dividend. The stock dividend was distributed on January 25, 2012 to shareholders of record as of January 17, 2012. All common stock accounts and per share data have been retroactively adjusted to give effect to the 2-for-1 split of the Company's common stock.

With respect to the unaudited financial information of the Company as of June 30, 2012 and for the three and six months ended June 30, 2012 and 2011, PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report dated July 27, 2012 appearing herein states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 for their report on the unaudited financial information because that report is not a report or a part of the registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this update generally represent clarifications of Topic 820, but also include some instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and IFRS. The amendments are effective for interim and annual periods beginning after December 15, 2011 and are to be applied prospectively. This update did not have any impact on the Company's consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. ASU No. 2011-05 was amended in December 2011 by ASU No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05. ASU No. 2011-12 defers only those changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments. All other requirements in ASU No. 2011-05 are not affected by ASU No. 2011-12, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. ASU No. 2011-05 and 2011-12 are effective for fiscal years (including interim periods) beginning after December 15, 2011. The Company has elected to present two separate but consecutive financial statements. These updates did not have any impact on the Company's consolidated financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The amendments in this update require enhanced disclosures around financial instruments and derivative instruments that are either (1) offset in accordance with either Accounting Standards Codification (ASC) 210-20-45 or ASC 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either ASC 210-20-45 or ASC 815-10-45. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The amendments are effective during interim and annual periods beginning on or after January 1, 2013. This guidance will primarily impact the Company's disclosures associated with its commodity derivatives. The Company does not expect this guidance to have any impact on its consolidated financial position, results of operations or cash flows.

Table of Contents**2. PROPERTIES AND EQUIPMENT, NET**

Properties and equipment, net are comprised of the following:

(In thousands)	June 30, 2012	December 31, 2011
Proved Oil and Gas Properties	\$ 5,376,987	\$ 5,006,846
Unproved Oil and Gas Properties	456,548	478,942
Gathering and Pipeline Systems	238,802	238,660
Land, Building and Other Equipment	82,464	80,908
	6,154,801	5,805,356
Accumulated Depreciation, Depletion and Amortization	(2,093,127)	(1,870,772)
	\$ 4,061,674	\$ 3,934,584

At June 30, 2012, the Company did not have any projects that had exploratory well costs that were capitalized for a period of greater than one year after drilling.

Divestitures

In June 2012, the Company sold a 35% non-operated working interest associated with certain of its Pearsall shale undeveloped leaseholds in south Texas to a wholly-owned subsidiary of Osaka Gas Co., Ltd. (Osaka) for total consideration of approximately \$251.1 million, subject to post-closing adjustments. The Company received \$125.0 million in cash proceeds and Osaka agreed to fund 85% of the Company's share of future drilling and completion costs associated with these leaseholds until it has paid approximately \$126.1 million in accordance with a joint development agreement entered into at the closing. The drilling and completion carry will terminate two years after the closing of the transaction. The Company recognized a \$67.0 million gain on sale of assets associated with this sale.

During the first six months of 2011, the Company entered into two participation agreements with third parties related to certain of its Haynesville and Bossier shale leaseholds in east Texas. Under the terms of the participation agreements, the third parties agreed to fund 100% of the cost to drill and complete certain Haynesville and Bossier shale wells in the related leaseholds over a multi-year period in exchange for a 75% working interest in the leaseholds. During the first six months of 2011, the Company received reimbursement of drilling costs incurred of approximately \$11.2 million associated with wells that had commenced drilling prior to the execution of the participation agreements.

In May 2011, the Company sold certain of its Haynesville and Bossier Shale oil and gas properties in east Texas to a third party. The Company received approximately \$47.0 million in cash proceeds and recognized a \$34.2 million gain on sale of assets.

Table of Contents**3. ADDITIONAL BALANCE SHEET INFORMATION**

Certain balance sheet amounts are comprised of the following:

(In thousands)	June 30, 2012	December 31, 2011
ACCOUNTS RECEIVABLE, NET		
Trade Accounts	\$ 82,915	\$ 111,306
Joint Interest Accounts	3,703	5,417
Other Accounts	3,561	1,003
	90,179	117,726
Allowance for Doubtful Accounts	(1,012)	(3,345)
	\$ 89,167	\$ 114,381
INVENTORIES		
Natural Gas in Storage	\$ 5,466	\$ 13,513
Tubular Goods and Well Equipment	6,247	7,146
Other Accounts	272	619
	\$ 11,985	\$ 21,278
OTHER CURRENT ASSETS		
Prepaid Balances and Other	4,821	2,345
Restricted Cash	1,907	2,234
	\$ 6,728	\$ 4,579
OTHER ASSETS		
Rabbi Trust Deferred Compensation Plan	\$ 11,146	\$ 10,838
Debt Issuance Cost	19,351	17,680
Equity Method Investment	2,078	
Other Accounts	1,317	1,342
	\$ 33,892	\$ 29,860
ACCOUNTS PAYABLE		
Trade Accounts	\$ 25,406	\$ 18,253
Natural Gas Purchases	3,062	3,012
Royalty and Other Owners	47,094	48,113
Accrued Capital Costs	153,061	138,122
Taxes Other Than Income	791	2,076
Drilling Advances	344	1,489
Wellhead Gas Imbalances	2,375	2,312
Other Accounts	5,284	3,917
	\$ 237,417	\$ 217,294
ACCRUED LIABILITIES		
Employee Benefits	\$ 11,375	\$ 26,035
Pension and Postretirement Benefits	4,838	6,331
Taxes Other Than Income	12,647	12,297
Interest Payable	23,557	24,701
Derivative Contracts	193	385
Other Accounts	1,506	1,169
	\$ 54,116	\$ 70,918
OTHER LIABILITIES		
Rabbi Trust Deferred Compensation Plan	\$ 20,883	\$ 20,187
Derivative Contracts	951	
Other Accounts	12,716	11,752
	\$ 34,550	\$ 31,939

Table of Contents**4. DEBT AND CREDIT AGREEMENTS**

The Company's debt and credit agreements consisted of the following:

(In thousands)	June 30, 2012	December 31, 2011
Long-Term Debt		
7.33% Weighted-Average Fixed Rate Notes	\$ 95,000	\$ 95,000
6.51% Weighted-Average Fixed Rate Notes	425,000	425,000
9.78% Notes	67,000	67,000
5.58% Weighted-Average Fixed Rate Notes	175,000	175,000
Credit Facility	210,000	188,000
	\$ 972,000	\$ 950,000

In May 2012, the Company amended its revolving credit facility to adjust the margins associated with borrowings under the facility and extend the maturity date from September 2015 to May 2017. The credit facility, as amended, provides for an available credit line of \$900 million with an accordion feature, which allows the Company to increase the available credit line by an additional \$500 million if one or more of the existing or new banks agree to provide such increased amount. Interest rates under the credit facility are based on Euro-Dollars (LIBOR) or Base Rate (Prime) indications, plus a margin, as follows:

	Debt Percentage					
	<25%	≥25% <50%	≥50% <75%	≥75% <90%	≥90%	
Eurodollar Loans	1.50%	1.75%	2.00%	2.25%	2.50%	
ABR Loans	0.50%	0.75%	1.00%	1.25%	1.50%	

The amended credit facility currently provides for a \$1.7 billion borrowing base. The other terms and conditions of the amended facility are generally consistent with the terms and conditions of the credit agreement prior to its amendment.

In conjunction with entering into the amendment to the credit facility, the Company incurred \$5.0 million of debt issuance costs, which were capitalized and will be amortized over the term of the amended credit facility. Approximately \$1.3 million in unamortized cost associated with the original credit facility was recognized as a debt extinguishment cost, which was included in Interest Expense and Other in the Condensed Consolidated Statement of Operations, and the remaining unamortized costs of \$11.0 million will be amortized over the term of the amended credit facility in accordance with ASC 470-50, Debt Modifications and Extinguishments.

At June 30, 2012, the Company had \$210.0 million of borrowings outstanding under the amended credit facility at a weighted-average interest rate of 3.3% and \$689.0 million available for future borrowings.

5. EQUITY METHOD INVESTMENT

Constitution Pipeline Company, LLC

The Company accounts for its investment in entities over which the Company has significant influence, but not control, using the equity method of accounting. Under the equity method of accounting, the Company records its proportionate share of net earnings, declared dividends and partnerships distributions based on the most recently available financial statements of the investee (generally on a one month lag). The Company also evaluates its equity method investments for potential impairment whenever events or changes in circumstances indicate that there is an other-than-temporary decline in the value of the investment.

In February 2012, the Company entered into a Precedent Agreement with Constitution Pipeline Company, LLC (Constitution), at the time a wholly owned subsidiary of Williams Partners L.P., to develop and construct a 120 mile large diameter pipeline to transport its production in northeast Pennsylvania to both the New England and New York markets. Under the terms of the Precedent Agreement, the Company will have transportation rights for up to approximately 500,000 Mcf per day of capacity on the newly constructed pipeline and the right to acquire a 25% equity interest in the project, subject to regulatory approval and certain terms and conditions to be determined.

In April 2012, the Company entered into an Amended and Restated Limited Liability Company Agreement (LLC Agreement) with Constitution, which thereby became an unconsolidated investee. Under the terms of the LLC Agreement, the Company acquired a 25% equity interest and agreed to

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invest approximately \$187 million, subject to a contribution cap of \$250 million. The investment, which is expected to occur over the next three years, will fund the development and construction of the pipeline and related facilities.

During the first six months of 2012, the Company made an initial contribution of \$2.1 million to fund the initial costs associated with the project. The Company's net book value in this equity investment was \$2.1 million as of June 30, 2012 and is included in Other Assets in the Condensed Consolidated Balance Sheet. There were no material earnings or losses associated with Constitution during the first six months of 2012. Earnings (losses) on Equity Method Investment are included in Interest Expense and Other in the Condensed Consolidated Statement of Operations.

6. EARNINGS PER COMMON SHARE

Basic EPS is computed by dividing net income (the numerator) by the weighted-average number of common shares outstanding for the period (the denominator). Diluted EPS is similarly calculated except that the denominator is increased using the treasury stock method to reflect the potential dilution that could occur if outstanding stock options and stock appreciation rights were exercised and stock awards were vested at the end of the applicable period.

The following is a calculation of basic and diluted weighted-average shares outstanding:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Weighted-Average Shares - Basic	209,512	208,528	209,320	208,408
Dilution Effect of Stock Options, Stock Appreciation Rights and Stock Awards at End of Period	1,646	2,146	1,654	1,768
Weighted-Average Shares - Diluted	211,158	210,674	210,974	210,176
Weighted-Average Stock Awards and Shares Excluded from Diluted Earnings per Share due to the Anti-Dilutive Effect	122	2	179	144

7. COMMITMENTS AND CONTINGENCIES

Transportation Agreements

During the first six months of 2012, the Company entered into a liquids transportation agreement that is expected to commence in the fourth quarter of 2012. The Company's total future minimum transportation commitments as of June 30, 2012 are as follows:

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(In thousands)

2012	\$	47,341
2013		120,765
2014		127,620
2015		127,698
2016		128,071
Thereafter		1,289,641
	\$	1,841,136

For further information on the Company's transportation agreements, please refer to Note 7 of the Notes to the Consolidated Financial Statements in the 2011 Form 10-K.

Legal Matters

Preferential Purchase Right Litigation

In September 2005, the Company and Linn Energy, LLC were sued by Power Gas Marketing & Transmission, Inc. in the Court of Common Pleas of Indiana County, Pennsylvania. The lawsuit seeks unspecified damages arising out of the Company's 2003 sale of oil and gas properties located in Indiana County, Pennsylvania, to Linn Energy, LLC. The plaintiff alleges breach of a preferential

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purchase right regarding those properties contained in a 1969 joint operating agreement, to which the plaintiff was a party. The Company initially obtained judgment as a matter of law as to all claims in a decision by the trial court dated February 2007. Plaintiff appealed the ruling to the Pennsylvania Superior Court, where the ruling in favor of the Company was reversed and remanded to the trial court in March 2008. The Company appealed the Superior Court ruling to the Pennsylvania Supreme Court, but in December 2008 that Court declined to review. Effective July 2008, Linn Energy, LLC sold the subject properties to XTO Energy, Inc., giving rise to a second lawsuit for unspecified damages filed in September 2009 by EXCO North Coast Energy, Inc., as successor in interest to Power Gas Marketing & Transmission, Inc., against the Company, Linn Energy, LLC and XTO Energy, Inc. The second lawsuit has been consolidated into the first lawsuit. A bench trial was held in early June 2012. Closing arguments have been set for mid-January 2013.

The Company believes that the plaintiff's claims lack merit and does not consider a loss related to this matter to be probable; however, due to the inherent uncertainties of litigation a loss is possible. In the event that the Company is found liable, the potential loss is currently estimated to be less than \$15 million.

Other

The Company is also a defendant in various other legal proceedings arising in the normal course of business. All known liabilities are accrued based on management's best estimate of the potential loss. While the outcome and impact of these legal proceedings on the Company cannot be predicted with certainty, management believes that the resolution of these proceedings will not have a material effect on the Company's financial position, results of operations or cash flows.

Contingency Reserves

When deemed necessary, the Company establishes reserves for certain legal proceedings. The establishment of a reserve is based on an estimation process that includes the advice of legal counsel and subjective judgment of management. While management believes these reserves to be adequate, it is reasonably possible that the Company could incur additional losses with respect to those matters in which reserves have been established. The Company believes that any such amount above the amounts accrued is not material to the Condensed Consolidated Financial Statements. Future changes in facts and circumstances could result in the actual liability exceeding the estimated ranges of loss and amounts accrued.

Environmental Matters

Pennsylvania Department of Environmental Protection

On December 15, 2010, the Company entered into a consent order and settlement agreement (CO&SA) with the Pennsylvania Department of Environmental Protection (PaDEP), addressing a number of environmental issues originally identified in 2008 and 2009, including alleged releases of drilling mud and other substances, alleged record keeping violations at various wells and alleged natural gas contamination of water supplies to 14 households in Susquehanna County, Pennsylvania. Prior to this settlement, the Company and PaDEP had entered into a number of

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consent orders, beginning in November 2009, requiring the Company to pay civil penalties and to undertake various remedial actions, including at various times making available potable water to the 14 households, plugging and abandoning three vertical natural gas wells in a nine square mile area in Susquehanna County and postponing the drilling of new natural gas wells in the area of concern until certain terms of the consent orders were fulfilled. Under the CO&SA, among other things, the Company agreed to place a total of \$4.2 million into escrow accounts for the benefit of each of the identified households, pay \$500,000 to the PaDEP to reimburse the PaDEP for its costs, perform remedial measures for two natural gas wells in the area of concern, provide pressure, water quality and water well headspace data to the PaDEP and offer water treatment to the households. The CO&SA settled all outstanding issues and claims that are known and that could have been brought against the Company by the PaDEP relating to the natural gas wells in the affected area and all prior consent orders. It also allows the Company to seek to begin hydraulic fracturing and to commence drilling new wells in the affected areas after providing the PaDEP with certain data and information. Under the CO&SA, the Company has no obligation to connect the impacted water supplies to a community public water system.

On January 11, 2011, certain of the affected households appealed the CO&SA to the Pennsylvania Environmental Hearing Board (PEHB).

The Company is in continuing discussions with the PaDEP to address the results of the Company's natural gas well test data, water quality sampling and water well headspace screenings, which were required pursuant to the CO&SA. The Company requested PaDEP approval to resume hydraulic fracturing and new natural gas well drilling operations in the affected area, along with a request to cease temporary water deliveries to the affected households. On October 18, 2011, the PaDEP concurred that temporary water deliveries to the property owners are no longer necessary.

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On November 18, 2011, certain of the affected households appealed to the PEHB the PaDEP's October 18, 2011 determination that temporary water deliveries were no longer necessary to the property owners and on November 23, 2011 filed a Petition for Supersedeas in the appeal. On December 9, 2011, the PEHB denied the Petition for Supersedeas and consolidated the appeal of the CO&SA with the appeal of the October 18, 2011 determination. A hearing on the consolidated matter is expected to occur in the second half of 2012.

As of June 30, 2012, the Company has paid \$1.3 million in settlement of fines and penalties sought or claimed by the PaDEP related to this matter, paid \$2.3 million (through the escrow process) to ten of the affected households and accrued a \$1.9 million settlement liability that represents the unpaid escrow balance, which is included in Other Liabilities in the Condensed Consolidated Balance Sheet.

United States Environmental Protection Agency

By letter dated January 6, 2012, the United States Environmental Protection Agency (EPA) sent a Required Submission of Information Dimock Township Drinking Water Contamination letter to the Company pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (CERCLA). The Required Submission of Information requested all documents, water sampling results and any other correspondence related to the Company's activities in the area of concern. The Company provided information pursuant to the request.

Upon review of information from Dimock residents, the PaDEP, and the Company, the EPA determined that further water well sampling was necessary and initiated two rounds of water sampling to address concerns about drinking water in Dimock. In July 2012, based on the outcome of the water sampling, the EPA determined that levels of contaminants do not pose a health concern and that it would take no further action.

8. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company periodically enters into commodity derivative instruments to hedge its exposure to price fluctuations on natural gas and crude oil production. The Company's credit agreement restricts the ability of the Company to enter into commodity hedges other than to hedge or mitigate risks to which the Company has actual or projected exposure or as permitted under the Company's risk management policies and not subjecting the Company to material speculative risks. All of the Company's derivatives are used for risk management purposes and are not held for trading purposes. As of June 30, 2012, the Company had 49 derivative contracts open: 23 natural gas price swap arrangements, six natural gas basis swap arrangements, 14 natural gas collar arrangements and six crude oil swap arrangements. During the first six months of 2012, the Company entered into 12 new derivative contracts covering anticipated crude oil production for 2012 and 2013 and natural gas production for 2013.

As of June 30, 2012, the Company had the following outstanding commodity derivatives:

Commodity and Derivative Type	Weighted-Average Contract Price	Volume	Contract Period
Derivatives Designated as Hedging Instruments			
Natural Gas Swaps	\$5.22 per Mcf	48,261 Mmcf	Jul. 2012 - Dec. 2012
Natural Gas Collars	\$3.09 Floor / \$4.12 Ceiling per Mcf	35,457 Mmcf	Jan. 2013 - Dec. 2013
Natural Gas Collars	\$5.15 Floor / \$6.20 Ceiling per Mcf	17,729 Mmcf	Jan. 2013 - Dec. 2013

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Crude Oil Swaps	\$100.45	per Bbl	1,041 Mbbl	Jul. 2012 - Dec. 2012
Crude Oil Swaps	\$101.90	per Bbl	1,095 Mbbl	Jan. 2013 - Dec. 2013

Derivatives Not Designated as Hedging

Instruments

Natural Gas Basis Swaps	\$(0.25)	per Mcf	8,568 Mmcf	Jul. 2012 - Dec. 2012
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The change in fair value of derivatives designated as hedges that is effective is recorded to Accumulated Other Comprehensive Income / (Loss) in Stockholders' Equity in the Condensed Consolidated Balance Sheet. The ineffective portion of the change in fair value of derivatives designated as hedges, if any, and the change in fair value of derivatives not designated as hedges are recorded currently in earnings as a component of Natural Gas Revenue and Crude Oil and Condensate Revenue, as appropriate, in the Condensed Consolidated Statement of Operations.

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The following disclosures reflect the impact of derivative instruments on the Company's condensed consolidated financial statements:

Effect of Derivative Instruments on the Condensed Consolidated Balance Sheet

(In thousands)	Balance Sheet Location	Fair Value Asset (Liability)	
		June 30, 2012	December 31, 2011
Derivatives Designated as Hedging Instruments			
Commodity Contracts	Derivative Instruments (current assets)	\$ 141,230	\$ 177,389
Commodity Contracts	Accrued Liabilities	(193)	(385)
Commodity Contracts	Derivative Instruments (non-current assets)	18,759	21,249
Commodity Contracts	Other Liabilities	(951)	
		158,845	198,253
Derivatives Not Designated as Hedging Instruments			
Commodity Contracts	Derivative Instruments (current assets)	(1,884)	(3,126)
		\$ 156,961	\$ 195,127

At June 30, 2012 and December 31, 2011, unrealized gains of \$158.9 million (\$97.2 million, net of tax) and \$198.3 million (\$121.4 million, net of tax), respectively, were recorded in Accumulated Other Comprehensive Income / (Loss). Based upon estimates at June 30, 2012, the Company expects to reclassify \$86.3 million in after-tax income associated with its commodity hedges from Accumulated Other Comprehensive Income / (Loss) to the Condensed Consolidated Statement of Operations over the next 12 months.

Effect of Derivative Instruments on the Condensed Consolidated Statement of Operations

Derivatives Designated as Hedging Instruments (In thousands)	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)				Location of Gain (Loss) Reclassified from Accumulated OCI into Income	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)			
	Three Months Ended June 30,		Six Months Ended June 30,			Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011		2012	2011	2012	2011
Commodity Contracts	\$ 18,376	\$ 48,314	\$ 89,104	\$ 60,887	Natural Gas Revenues	\$ 69,732	\$ 13,667	\$ 126,728	\$ 27,148
					Crude Oil and Condensate Revenues	3,110	(514)	1,784	(816)
						\$ 72,842	\$ 13,153	\$ 128,512	\$ 26,332

For the three and six months ended June 30, 2012 and 2011, respectively, there was no ineffectiveness recorded in our Condensed Consolidated Statement of Operations related to our derivative instruments.

Derivatives Not Designated as Hedging Instruments (In thousands)	Location of Gain (Loss) Recognized in Income on Derivative	Three Months Ended June 30,		Six Months Ended June 30,	
		2012	2011	2012	2011
Commodity Contracts	Natural Gas Revenues	\$ (342)	\$ (903)	\$ (300)	\$ (886)

Additional Disclosures about Derivative Instruments and Hedging Activities

The use of derivative instruments involves the risk that the counterparties will be unable to meet their obligation under the agreement. The Company enters into derivative contracts with multiple counterparties in order to limit its exposure to individual counterparties. The Company also has netting arrangements with all of its counterparties that allow it to offset payables against receivables from separate derivative contracts with that counterparty.

Certain counterparties to the Company's derivative instruments are also lenders under its credit facility. The Company's credit facility and derivative instruments contain certain cross default and acceleration provisions that may require immediate payment of its derivative liability in certain situations.

Table of Contents**9. FAIR VALUE MEASUREMENTS**

ASC 820, Fair Value Measurements and Disclosures, established a formal framework for measuring fair values of assets and liabilities in financial statements that are already required by generally accepted accounting principles (GAAP) to be measured at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The transaction is based on a hypothetical transaction in the principal or most advantageous market considered from the perspective of the market participant that holds the asset or owes the liability.

The Company utilizes market data or assumptions that market participants who are independent, knowledgeable and willing and able to transact would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. The Company attempts to utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Company is able to classify fair value balances based on the observability of those inputs. ASC 820 establishes formal fair value hierarchy based on the inputs used to measure fair value. The hierarchy gives the highest priority to Level 1 measurements and the lowest priority to Level 3 measurements.

The Company has classified its assets and liabilities into these levels depending upon the data relied on to determine the fair values. For further information regarding the fair value hierarchy, refer to Note 13 of the Notes to the Consolidated Financial Statements in the 2011 Form 10-K.

Non-Financial Assets and Liabilities

The Company discloses or recognizes its non-financial assets and liabilities, such as impairments of long-lived assets, at fair value on a nonrecurring basis. As none of the Company's non-financial assets and liabilities were impaired as of June 30, 2012 and 2011 and no other assets or liabilities were required to be measured at fair value on a non-recurring basis, additional disclosures are not provided.

Financial Assets and Liabilities

The Company's financial assets and liabilities are measured at fair value on a recurring basis. The following fair value hierarchy table presents information about the Company's financial assets and liabilities measured at fair value on a recurring basis:

(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of June 30, 2012
Assets				
Rabbi Trust Deferred Compensation Plan	\$ 11,146	\$	\$	\$ 11,146

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Derivative Contracts			27,748		130,357		158,105
Total Assets	\$	11,146	\$	27,748	\$	130,357	\$ 169,251
Liabilities							
Rabbi Trust Deferred Compensation Plan	\$	20,883	\$		\$		20,883
Derivative Contracts					1,144		1,144
Total Liabilities	\$	20,883	\$		1,144	\$	22,027

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(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2011
Assets				
Rabbi Trust Deferred Compensation Plan	\$ 10,838	\$	\$	\$ 10,838
Derivative Contracts			195,512	195,512
Total Assets	\$ 10,838	\$	\$ 195,512	\$ 206,350
Liabilities				
Rabbi Trust Deferred Compensation Plan	\$ 20,187	\$	\$	\$ 20,187
Derivative Contracts			385	385
Total Liabilities	\$ 20,187	\$	\$ 385	\$ 20,572

The Company's investments associated with its Rabbi Trust Deferred Compensation Plan consist of mutual funds and deferred shares of the Company's common stock that are publicly traded and for which market prices are readily available.

The derivative contracts were measured based on quotes from the Company's counterparties. Such quotes have been derived using an income approach that considers various inputs including current market and contractual prices for the underlying instruments, quoted forward prices for natural gas and crude oil, basis differentials, volatility factors and interest rates, such as a LIBOR curve for a similar length of time as the derivative contract term, as applicable. These estimates are verified using relevant NYMEX futures contracts or are compared to multiple quotes obtained from counterparties for reasonableness. The determination of the fair values presented above also incorporates a credit adjustment for non-performance risk, as required by GAAP. The Company measured the non-performance risk of its counterparties by reviewing credit default swap spreads for the various financial institutions in which it has derivative transactions, while non-performance risk of the Company is evaluated using a market credit spread provided by the Company's bank.

The significant unobservable inputs for Level 3 derivative contracts include basis differentials and volatility factors. An increase (decrease) in these unobservable inputs would result in an increase (decrease) in fair value, respectively. The Company does not have access to the specific assumptions used in its counterparties' valuation models. Consequently, additional disclosures regarding significant Level 3 unobservable inputs were not provided.

The following table sets forth a reconciliation of changes in the fair value of financial assets and liabilities classified as Level 3 in the fair value hierarchy:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Balance at beginning of period	\$ 218,942	\$ 14,158	\$ 195,127	\$ 14,746
Total Gains / (Losses) (Realized or Unrealized):				
Included in Earnings (1)	69,390	12,249	126,428	25,446
Included in Other Comprehensive Income	(90,234)	35,161	(67,541)	34,555
Settlements	(68,885)	(13,153)	(125,186)	(26,332)
Transfers In and/or Out of Level 3			385	
Balance at end of period	\$ 129,213	\$ 48,415	\$ 129,213	\$ 48,415

(1) Unrealized losses of \$0.3 million and \$0.9 for the three months ended June 30, 2012 and 2011, respectively, and unrealized losses of \$0.3 million and \$0.9 million for the six months ended June 30, 2012 and 2011, respectively, were included in Natural Gas Revenues in the Condensed Consolidated Statement of Operations.

There were no transfers between Level 1 and Level 2 measurements for the six months ended June 30, 2012 and 2011.

Fair Value of Other Financial Instruments

The estimated fair value of financial instruments is the amount at which the instrument could be exchanged currently between willing parties. The carrying amounts reported in the Condensed Consolidated Balance Sheet for cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturities of these instruments.

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The fair value of long-term debt is the estimated cost to acquire the debt, including a credit spread for the difference between the issue rate and the period end market rate. The credit spread is the Company's default or repayment risk. The credit spread (premium or discount) is determined by comparing the Company's fixed-rate notes and credit facility to new issuances (secured and unsecured) and secondary trades of similar size and credit statistics for both public and private debt. The fair value of all fixed-rate notes and the credit facility is based on interest rates currently available to the Company. The Company's long-term debt is valued using an income approach and classified as Level 3 in the fair value hierarchy.

The Company uses available market data and valuation methodologies to estimate the fair value of debt. The carrying amounts and fair values of long-term debt are as follows:

(In thousands)	June 30, 2012		December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Long-Term Debt	\$ 972,000	\$ 1,115,085	\$ 950,000	\$ 1,082,531

10. ACCUMULATED COMPREHENSIVE INCOME / (LOSS)

Changes in the components of Accumulated Other Comprehensive Income / (Loss), net of taxes, for the six months ended June 30, 2012 were as follows:

(In thousands)	Net Gains / (Losses) on Cash Flow Hedges	Defined Benefit Pension and Postretirement Plans	Total
Balance at December 31, 2011	\$ 121,358	\$ (16,811)	\$ 104,547
Net change in unrealized gain on cash flow hedges, net of taxes of \$15,210	(24,198)		(24,198)
Net change in defined benefit pension and postretirement plans, net of taxes of \$(5,380)		8,484	8,484
Balance at June 30, 2012	\$ 97,160	\$ (8,327)	\$ 88,833

11. PENSION AND OTHER POSTRETIREMENT BENEFITS

The components of net periodic benefit costs, included in General and Administrative Expense in the Condensed Consolidated Statement of Operations, were as follows:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Qualified and Non-Qualified Pension Plans				

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Interest Cost	\$	461	\$	800	\$	922	\$	1,601
Expected Return on Plan Assets		(874)		(1,160)		(1,748)		(2,320)
Settlement		7,111				7,111		
Amortization of Prior Service Cost		110		316		221		633
Amortization of Net Loss		6,541		3,062		13,083		6,124
Net Periodic Pension Cost	\$	13,349	\$	3,018	\$	19,589	\$	6,038

Postretirement Benefits Other than Pension Plans

Current Period Service Cost	\$	523	\$	334	\$	1,046	\$	669
Interest Cost		418		468		836		935
Amortization of Net Loss		280		141		560		282
Amortization of Net Obligation at Transition				158				316
Total Postretirement Benefit Cost	\$	1,221	\$	1,101	\$	2,442	\$	2,202

Termination and Amendment of Qualified Pension Plan

In July 2010, the Company notified its employees of its plan to terminate its qualified pension plan, with the plan and its related trust to be liquidated following appropriate filings with the Pension Benefit Guaranty Corporation and Internal Revenue Service, effective

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September 30, 2010. The Company then amended and restated the qualified pension plan to freeze benefit accruals, to provide for termination of the plan, to allow for an early retirement enhancement to be available to all active participants as of September 30, 2010 regardless of their age and years of service as of that date, and to make certain changes that were required or made desirable as a result of developments in the law.

On March 14, 2012, the Internal Revenue Service provided the Company with a favorable determination letter for the termination of the Company's qualified pension plan. In June and July 2012, the Company made final contributions of \$9.6 million and \$3.6 million, respectively, to fund the liquidation of the trust under the qualified pension plan. As of July 13, 2012, the benefit obligations associated with the qualified pension plan were fully satisfied.

For further information regarding termination and amendment of the Company's pension plans, refer to Note 5 of the Notes to the Consolidated Financial Statements in the 2011 Form 10-K.

12. STOCK-BASED COMPENSATION

Stock-based compensation expense (including the supplemental employee incentive plan) during the first six months of 2012 and 2011 was \$13.1 million and \$19.3 million, respectively, and is included in General and Administrative Expense in the Condensed Consolidated Statement of Operations. Stock-based compensation expense in the second quarter of 2012 and 2011 was \$11.4 million and \$11.2 million, respectively.