Rosetta Resources Inc.
Form 10-K
March 16, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

x **Annual Report Pursuant To Section 13 or 15(d) of The Securities Exchange Act of 1934**

For The Fiscal Year Ended December 31, 2006

OR

¨ **Transition Report Pursuant To Section 13 Or 15(d) of The Securities Exchange Act of 1934**

Commission File Number: 000-51801

ROSETTA RESOURCES INC.
(Exact name of registrant as specified in its charter)

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

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

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, $.001 Par Value	**The Nasdaq Stock Market LLC**
(Title of Class)	(Name of Exchange on which registered)

Securities Listed Pursuant to Section 12 (g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes ¨ Nox

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ¨ Nox

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Securities Exchange Act of 1934. Large accelerated filer ¨ Accelerated filer ¨ Non-Accelerated filer x

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2006 was approximately $831 million based on the closing price of $16.62 per share on the Nasdaq Global Select Market.

The number of shares of the registrant's Common Stock, $.001 par value per share outstanding as of March 5, 2007 was 50,753,951.

Documents Incorporated By Reference

Information required by Part III will either be included in Rosetta Resources Inc.'s definitive proxy statement filed with the Securities and Exchange Commission or filed as an amendment to this Form 10-K no later than 120 days after the end of the Company's fiscal year, to the extent required by the Securities Exchange Act of 1934, as amended.

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Cautionary Note

This Annual Report contains forward-looking statements of our management regarding factors that we believe may affect our performance in the future. Such statements typically are identified by terms expressing our future expectations or projections of revenues, earnings, earnings per share, cash flow, market share, capital expenditures, effects of operating initiatives, gross profit margin, debt levels, interest costs, tax benefits and other financial items. All forward-looking statements, although made in good faith, are based on assumptions about future events and are, therefore, inherently uncertain; and actual results may differ materially from those expected or projected. Important factors that may cause our actual results to differ materially from expectations or projections include those described under the heading "Forward-Looking Statements" in Item 7. Forward-looking statements speak only as of the date of this report, and we undertake no obligation to update or revise such statements to reflect new circumstances or unanticipated events as they occur.

For a glossary of oil and natural gas terms, see page 97.

Part I

Item 1. Business

General

Rosetta Resources Inc. (together with our consolidated subsidiaries, the "Company") was formed in June 2005 to acquire Calpine Natural Gas L.P. the domestic oil and natural gas business formerly owned by Calpine Corporation and affiliates ("Calpine"). The Company ("Successor") acquired Calpine Natural Gas L.P. ("Predecessor") in July 2005 (hereinafter, the "Acquisition") and together with all subsequently acquired oil and gas properties is engaged in oil and natural gas exploration, development, production and acquisition activities in the United States and operates in one business segment. Our operations are primarily concentrated in the Sacramento Basin of California, the Lobo and Perdido Trends in South Texas, the State Waters of Texas, the Gulf of Mexico and the Rocky Mountains. The Company has grown its existing property base through exploitation of its leasehold acreage and by: purchasing new undeveloped leases; acquiring oil and gas producing properties from third parties; and acquiring drilling prospects with third parties where the Company earns an ownership interest in new third party properties or otherwise participates in exploration.

Pursuant to the Acquisition, we entered into several operative contracts with Calpine, including a purchase and sale agreement (together with the interrelated agreements concurrently executed on or about July 7, 2005, are hereinafter, collectively, the "Purchase Agreement") under which we have indemnification rights and obligations with respect to Calpine. Currently, Calpine markets our oil and gas under a marketing services agreement whose term runs through June 30, 2007. We also sell a significant portion of our gas to Calpine pursuant to certain gas purchase and sales contracts, all of which were part of the Acquisition documents.

In October 1999, Calpine purchased Sheridan Energy, Inc. ("Sheridan"), a natural gas exploration and production company operating in northern California and the Gulf Coast region. Sheridan, renamed Calpine Natural Gas Company, provided the initial management team an operational infrastructure to evaluate and acquire oil and natural gas properties for Calpine. In December 1999, Calpine purchased Vintage Petroleum, Inc.'s interest in the Rio Vista Gas Unit and related areas, representing primarily natural gas reserves located in the Sacramento Basin in northern California. In October 2001, Calpine Natural Gas Company completed the acquisition of 100% of the voting stock of Michael Petroleum Corporation, a natural gas exploration and production company with operations in South Texas. Calpine Natural Gas Company was merged into Calpine in April 2002, and Calpine Natural Gas L.P. was subsequently established. In September 2004, Calpine and Calpine Natural Gas L.P. sold their natural gas reserves in the New Mexico San Juan Basin and Colorado Piceance Basin and such properties have been reflected as discontinued operations for all periods presented herein. Several members of the Calpine management team, who were responsible for operating Calpine's oil and natural gas business, joined the Company concurrently with the Acquisition.

Our Strengths

We believe our historical success is, and future performance will be, directly related to the following combination of strengths:

High Quality, Diversified Asset Base. We own a geographically diversified asset base comprised of long-lived reserves along with shorter-lived, higher return reserves. Approximately 96% of our reserves are natural gas and almost all of our assets are located in the Sacramento Basin of California, South Texas, the Gulf of Mexico and the Rocky Mountains. We believe this geographic and production profile diversity will enhance the stability of our cash flows while providing us with a large number of development and exploration opportunities, as well as support for additional acquisitions.

Development and Exploration Drilling Inventory. We have identified over 500 drillable, low to moderate risk opportunities providing us with multiple years of drilling inventory, and we expect to drill approximately 190 of these locations during 2007. Approximately 20% of these locations are classified as proved undeveloped. We also have a large and diversified portfolio of what we designate as development and exploration prospects. Our capital expenditure budget is approximately $250 million for 2007. We will manage our exploratory risks and expenditures by selectively reducing our capital exposure in certain high risk projects by partnering with others in our industry.

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Operational Control. We operate approximately 90% of our estimated proved reserves, which allows us to more effectively manage expenses and control the timing of capital allocation of our development and exploration activities.

Experienced Management Team. Our executive management team has an average of over 30 years of experience in the oil and natural gas industry as well as strong technological backgrounds.

Proven Technical and Land Personnel with Access to Technological Resources. Our technical staff of 28 includes geologists, geophysicists, landmen, engineers and technicians with an average of over 20 years of relevant technical experience. Our staff has a proven record of analyzing complex structural and stratigraphic plays using 3-D geophysical expertise, producing and optimizing low pressure natural gas reservoirs, detecting low contrast, low permeability pay opportunities, drilling, completing and fracing of deep tight natural gas reservoirs operating in the Gulf of Mexico and managing horizontal drilling and coalbed methane operations. These core competencies helped us to achieve a drilling success rate of 85% for the year ended December 31, 2006 and has helped maximize recovery from our reservoirs. Our definition of drilling success is a well that produces hydrocarbons at sufficient rates to allow us to recover, at a minimum, our capital investment and operating costs.

Our Strategy

Our strategy is to increase stockholder value by profitably increasing our reserves, production, cash flow and earnings using a balanced program of (1) developing existing properties, (2) exploring undeveloped properties, (3) completing strategic acquisitions (4) maintaining financial flexibility (5) striving to be a low cost producer, and (6) maintaining financial flexibility. We will seek to accomplish these goals while working to protect shareholder interests by conserving natural resources, monitoring emerging trends, minimizing liabilities through an aggressive approach to governmental compliance, respecting the dignity of human life, and protecting the environment. The following are key elements of our strategy:

Further Development to Existing Properties. We intend to further develop the significant remaining upside potential of our properties by working over existing wells, drilling in-fill locations, drilling step-out wells to expand known field outlines, recomplete to logged behind pipe pays and lowering field line pressures through compression for additional reserve recovery.

Exploration Growth. We intend to focus on niche areas in which we have technological and operational advantages. This growth will come from higher-risk, higher-impact opportunities in the Gulf of Mexico, Texas and Louisiana State Waters, in deep horizons in the Sacramento Basin, and from lower-risk, longer-lived opportunities in the shallow Sacramento Basin, the Lobo and Perdido Sand Trends in South Texas, Niobrara chalk in the DJ Basin and coalbed methane in the San Juan Basin. While the majority of our prospects will be internally generated, we will, from time to time, participate in third-party drilling opportunities.

Acquisition Growth. We continually review opportunities to acquire producing properties, undeveloped acreage and drilling prospects. We focus on opportunities where we believe our reservoir management and operational expertise will enhance the value and performance of acquired properties. Acquisition targets will generally be in and around our major producing and activity areas. We will also use our minor producing field ownerships as islands of control and knowledge to make strategic acquisitions. Historically, our management team has demonstrated success in oil and gas acquisitions and has developed a significant oil and gas knowledge base in fields throughout the United States.

Maintain Technological Expertise. We intend to maintain the technological expertise that helped us achieve a drilling success rate of 85% for the year ended December 31, 2006, and helped us maximize field recoveries. We will use advanced geological and geophysical technologies, detailed petrophysical analyses, state-of-the-art reservoir engineering and sophisticated completion and stimulation techniques to grow our reserves and production.

Endeavor to be a Low Cost Producer. We will strive to minimize our operating costs by concentrating our assets within geographic areas where we can capture operating efficiencies. This is particularly true in the Sacramento Basin and South Texas where we are a dominant producer in each region.

Maintain Financial Flexibility. We intend to optimize unused borrowing capacity under our revolving line of credit by periodically refinancing our bank debt in the capital markets when conditions are favorable. As of December 31, 2006, we had $159.0 million available for borrowing under our revolving line of credit. Additionally, we expect internally generated cash flow to provide additional financial flexibility, allowing us to pursue our business strategy. We intend to actively manage our exposure to commodity price risk in the marketing of our oil and natural gas production. As part of this strategy and in connection with our credit facilities, we entered into natural gas fixed-price swaps and costless collar transactions for a significant portion of our expected production through 2009. We may enter into other agreements, including fixed price, forward price, physical purchase and sales, futures, financial swaps, option and put option contracts.

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Calpine Bankruptcy

On December 20, 2005 Calpine and certain of its subsidiaries filed for protection under federal bankruptcy laws in the United States Bankruptcy Court of the Southern District of New York (the "Bankruptcy Court"). The filing raises certain concerns regarding aspects of our relationship with Calpine which we will continue to closely monitor as the Calpine bankruptcy proceeds. See Item 3. Legal Proceedings for further information regarding the Calpine bankruptcy.

Our Operating Areas

We own producing and non-producing oil and natural gas properties in the Sacramento Basin of California, the Lobo and Perdido Trends in South Texas, the State Waters of Texas, the Gulf of Mexico, the Rocky Mountains and other properties located in various geographical areas in the United States. In each area we are pursuing geological objectives and projects that are consistent with our technical expertise in order to provide the highest potential economic returns. For the year ended December 31, 2006, we have drilled 142 gross and 120 net wells, of which 85% found commercial quantities of production. The following is a summary of our major operating areas in which we discuss their various characteristics. With respect to acreage information in this report, we have included acreage relating to properties for which legal title was not given to us by Calpine on the original date of Acquisition because consents to transfer, which the parties believed at that time were required, had not been obtained as of July 7, 2005. See Item 3. Legal Proceedings for further information regarding the Calpine bankruptcy.

California-Sacramento Basin

Rio Vista Field and Surrounding Area. The Rio Vista Gas Unit and a significant portion of the deep rights below the Rio Vista Gas Unit, together constitute the greater Rio Vista Field, is the largest onshore natural gas field in California and one of the 15 largest natural gas fields in the United States. The field has produced a cumulative 3.6 Tcfe of natural gas reserves to date since its discovery in 1936. We currently produce from or have behind-pipe reserves in over 16 different zones at depths ranging from 2,500 feet to 9,300 feet in the field. The natural gas field trap is a faulted, downthrown rollover anticline, elongated to the northwest. The current productive area is approximately ten miles long and eight miles wide. A majority of the reservoirs are depletion driven with long production histories. For the twelve months ended December 31, 2006, the average net daily production in the Sacramento Basin was approximately 31 MMcfe from 142 producing wells. As of December 31, 2006, we owned approximately 77,000 net acres in the Rio Vista Field and surrounding Sacramento Basin areas. We are one of the largest producers and leaseholders in the basin. Our acreage in the basin holds significant low-risk, low-cost upside potential in 117 currently shut-in or idle wells, and over 110 drillable locations, and numerous workover and recompletion opportunities. Additional reserve potential exists in gathering system optimization projects, numerous fracture stimulation opportunities in lower permeability, low contrast pays, and deeper gas bearing sands.

We drilled 19 successful wells in and around the Rio Vista field in 2006. Six wells were drilled in the southern portion of the field in extending pays in three reservoirs: Upper Capay, Lower Capay and Martinez. A 12-square mile 3-D program was shot over the Bradford Island area of the field. This area of the field previously has never been covered by seismic data.

Sacramento Valley Extension. We believe our existing land position and financial strength will give us the ability to continue expanding our Sacramento Basin operations. The Sacramento Valley Extension Project is an extension of work and study done in the redevelopment of the Rio Vista Field and non-operated drilling in nearby reservoirs. Numerous plays are being evaluated, including Mokelumme gorge traps and McCormick fault traps, deeper Winters traps, and shallow Emigh/Capay truncation traps on the east side of the Sacramento Basin. Low contrast and low resistivity pays in the Emigh, Capay, Hamilton and Martinez formations are being pursued for under-exploited and unrecognized potential. We have approximately 581 square miles of 3-D seismic data and over 2,216 miles of 2-D seismic data in Rio Vista, the extension area, and the greater Sacramento Valley. The area contains 16 prospective producing formations with historically high production rates at shallow to moderate drill depths.

Other Activities. We are actively pursuing additional lease acquisitions throughout the Sacramento Basin. In 2006, we added approximately 16,400 acres to our leasehold inventory. We have one rig actively drilling in the field. We will be procuring a deep rig in the summer to drill three deep tests. In all, we plan to drill 30 wells in 2007. There are three completion rigs currently working on Rosetta wells in the Rio Vista area. Other than new well completions, we plan to conduct between 30 and 40 workover, recompletion or reactivation operations on field wells with these rigs during 2007.

Lobo

Lobo Trend. Discovered in 1973, the Lobo Trend of South Texas is a complex, highly faulted sand that has produced over 7 Tcf of natural gas. The Lobo section produces from tight sands with low permeabilities and high pressures at depths from 7,500 to 10,000 feet. We are a significant producer in the Lobo Trend, with over 65,000 net acres, 320 square miles of 3-D seismic data, approximately 239 active operated wells and interests in approximately 120 non-operated wells. We recently added a new acreage position in the heart of our acreage in the Lobo Trend. For the year ended December 31, 2006, our average net daily production from the Trend was 26.5 MMcfe. Our working interests range from 50% to 100%. We have identified 90 potential drilling locations on our acreage.

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We have two drilling rigs under contract for the drilling program, and we plan to drill 30 wells in the Trend in 2007. We drilled 21 successful wells in 2006.

Perdido

Perdido Sand Trend. We own a 50% non-operating working interest in approximately 17,500 acres in the Perdido Sand Trend. The Perdido Sands are in isolated fault blocks and are stratigraphically trapped below the Upper Wilcox structures at approximately 8,000 to 9,500 feet. The Perdido Sands are comprised of tight natural gas sands requiring significant fracture stimulation. Horizontal drilling has been very successful in maximizing natural gas recovery. We plan to maintain our current acreage and seismic position and to continue to improve horizontal drilling techniques to lower cost and increase performance. For the twelve months ended December 31, 2006, our average net daily production was 11.4 MMcfe from 28 producing wells. We participated in the drilling of 7 horizontal wells in 2006 with 6 successful. Two of the 7 wells were drilled in 2006 and completed in January 2007. We plan to drill 7 additional wells in 2007.

Gulf of Mexico

Federal Waters. The Company owns working interests in 11 blocks ranging from 20% to 100%. We have satisfied the regulatory requirement for receiving ministerial approval in all the offshore blocks in the Gulf of Mexico except for four blocks for which we have not received Mineral Management Service's ("MMS") ministerial approvals. In 2006, we acquired ownership interests in another three blocks in the Gulf of Mexico. For the year ended December 31, 2006, our average net daily production from these blocks was 8.3 MMcfe.

During 2006, through our participation in a joint venture, we acquired a 25% non-operated working interest in two OCS blocks, Main Pass Block 118 and Main Pass Block 117. Main Pass Block 118 well No. 1 was drilled, production casing set, successfully tested and is awaiting platform installation. The Block 117 well No. 1 was a dry hole. We acquired a 50% working interest in Main Pass Block 29 and a 25% working interest in Grand Isle Block 72. These wells will be placed on production in 2007. We plan to drill 2 additional wells in the Gulf of Mexico in 2007.

We have entered into an Area of Mutual Interest ("AMI") agreement in which we have the right to participate in up to a 50% working interest in wells within 150 Outer Continental Shelf ("OCS") blocks on the Louisiana offshore shelf. We have obtained MMS leases for another three OCS blocks. We intend to participate in the drilling of at least one to two new prospects each year in these blocks, as well as other blocks in which we may obtain leases.

State Waters of Texas

Galveston Bay. We continue exploring in the Vicksburg and Frio Trends in Galveston Bay, Texas, specifically pursuing sands that exhibit strong hydrocarbon indicators on 3-D seismic.

In 2006 we participated in the drilling of 5 wells; one of which is on production, two waiting on production facilities and two dry holes. Over average net daily production was 3.1 MMcfe for 2006. We plan to drill 4 additional wells in 2007.

Sabine Lake. We own a 50% operated working interest through a joint venture in Sabine Lake, within Texas State Waters of Jefferson County. We are currently drilling a 13,000 foot test well which is one of four expected to be drilled in 2007. We currently hold interest in approximately 2,100 gross acres and have recently acquired an additional interest in approximately 4,800 acres in the same area.

Other Onshore

Live Oak County Prospect. Through the interpretation of 3-D seismic data, we have identified four structures at approximately 16,500 feet in the Sligo Reef Trend in Live Oak County, Texas. Two of these structures were previously drilled and produced by other operators. One structure has produced 33 Bcfe since 1983 from one well on the south end of our 3-D data coverage, and a second structure on the north end of our data coverage produced 13 Bcfe since 1987, also from one well. We currently have approximately 2,500 net acres under lease and have obtained a partner to join in the drilling of the initial exploratory well to a depth of 17,000 feet. The Exploration Agreement provides for the formation of an AMI covering approximately 22,000 acres for exploration and development purposes. The initial well should commence operations prior to August 31, 2007.

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Frio, Vicksburg, Yegua and Wilcox Trends. In Colorado and Wharton Counties, we are pursuing amplitude plays between 3,500 and 7,000 feet in the Frio and Yegua Trends. In the Wilcox Trend, we are pursuing normally pressured structural closures at 10,000 feet and over-pressured closures from 14,000 to 17,500 feet. All of these projects are based on 3-D seismic data. In 2006, we drilled 6 wells and participated in 2 others, with a 50% success rate. We continue to look for additional opportunities in these trends.

We plan to drill 18 additional wells in 2007 in the Other Onshore area.

Rocky Mountains

We are active in the DJ and San Juan Basins in the Rocky Mountains.

DJ Basin, Colorado. As of December 31, 2006, we had a majority working interest in approximately 95,000 net acres in the Niobrara Chalk play at 2,500 feet. In 2006 we drilled 46 locations, 43 of which were successful. As of December 31, 2006 we have identified approximately 200 additional locations on our existing leases with 70 wells planned for 2007. For the year ended December 31, 2006, our average production from the area was approximately 1 MMcfe/d.

By December 31, 2006, we had acquired 91.1 square miles of 3D seismic data, 61 square miles of which was acquired in 2006. We are using 3-D seismic data as a critical tool in identifying potential drilling opportunities. We drilled 33 successful wells out of 33 attempts in the Republican River 3-D area in 2006. Pipeline and gathering system construction is underway in the Republican River. Additional pipeline, gathering line and water collection pits were permitted and installed in the Kitzmiller area.

San Juan Basin, New Mexico. The San Juan Basin is the second most prolific gas basin in North America, according to published articles, with 34 Tcf of production through the end of October 2004, 11.4 Tcf of which comes from the Fruitland Coal CBM ("Coal Bed Methane"). There is Fruitland Coal production from depths of 1,600 feet surrounding our leasehold. We are pursuing this coalbed methane play and had, as of December 31, 2006, a 100% working interest position in approximately 7,500 acres. The well permitting process is ongoing. In 2006 we drilled 14 Fruitland Coal CBM wells and 1 saltwater disposal well. We have identified 40 drillable locations on our San Juan Basin leases with 18 wells planned for 2007.

Mid-Continent

Texas Panhandle —Price Ranch Project. On February 10, 2006, we acquired a farmout from BP on approximately 12,800 acres in Sherman County, Texas, to explore for oil and gas reserves in the Marmaton Limestone and Morrow Sandstone. The acreage is held by production by shallower Chase Formation Hugoton gas production. The farmout includes access to a proprietary BP 22 square miles of 3-D seismic survey, which was reprocessed for prospect development. We have acquired a 3.5-mile 2-D seismic line to evaluate several well locations offsetting existing Marmaton production. Three drillable prospects resulted from the seismic and geologic evaluations. Subsequent to December 31, 2006, one of these prospects has been drilled, and another is expected to commence drilling by the end of the first quarter of 2007.

Crude Oil and Natural Gas Operations

Production by Operating Area

The following table presents certain information with respect to our production data for the period presented:

	For the Year Ended December 31, 2006 (1)		
	Natural Gas (Bcf)	Oil (MMBbls)	Equivalents (Bcfe)
California	11.4	-	11.5
Lobo	9.3	-	9.7
Perdido	4.0	-	4.2
State Waters	1.1	-	1.1
Gulf of Mexico	1.5	0.3	3.0
Other Onshore	2.4	0.2	3.3
Rocky Mountains	0.4	-	0.4
Mid-Continent	0.2	-	0.2
	30.3	0.5	33.4

(1) Excludes properties not conveyed as part of the Acquisition of the domestic oil and natural gas properties of Calpine, as described in the footnotes for proved reserves below.

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Proved Reserves

There are a number of uncertainties inherent in estimating quantities of proved reserves, including many factors beyond our control, such as commodity pricing. Therefore, the reserve information in this report represents only estimates. Reserve engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact manner. The accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. As a result, estimates of different engineers may vary. In addition, results of drilling, testing and production subsequent to the date of an estimate may justify revising the original estimate. Accordingly, initial reserve estimates are often different from the quantities of oil and natural gas that are ultimately recovered. The meaningfulness of such estimates depends primarily on the accuracy of the assumptions upon which they were based. Except to the extent that we acquire additional properties containing proved reserves or conduct successful exploration and development activities, or both, our proved reserves will decline as reserves are produced.

As of December 31, 2006, we had 407.8 Bcfe of proved oil and natural gas reserves, including 390.2 Bcf of natural gas and 2,930 MBbls of oil and condensate. Using prices as of December 31, 2006, (adjusted for basis and quality differentials) the estimated standardized measure of discounted future net cash flows was $721.7 million. The following table sets forth by operating area a summary of our estimated net proved reserve information as of December 31, 2006:

	Estimated Proved Reserves at December 31, 2006 (1)(2)(3)			
	Developed (Bcfe)	**Undeveloped (Bcfe)**	**Total (Bcfe)**	**Percent of Total Reserves**
California	115.4	37.2	152.6	37%
Lobo	87.7	83.7	171.4	42%
Perdido	8.3	11.6	19.9	5%
State Waters	2.2	-	2.2	1%
Gulf of Mexico	13.8	1.8	15.6	4%
Other Onshore	18.4	6.6	25.0	6%
Rockies	15.0	3.5	18.5	4%
Mid-Continent	2.1	0.5	2.6	1%
Total	262.9	144.9	407.8	100%

(1) These estimates are based upon a reserve report prepared by Netherland Sewell & Associates, Inc. (hereafter "Netherland Sewell") using criteria in compliance with the Securities and Exchange Commission ("SEC") guidelines and excludes 23.4 Bcfe of proved oil and gas reserves with an SEC PV-10 value of $53.0 million pretax representing the total allocated value of wells and the associated leases described in footnote 2 below.

(2) At the July 2005 closing of the Acquisition, we withheld $68 million for properties (excluding that portion of the properties subject to the preferential right) which Calpine agreed to transfer legal title to us but for which Calpine had not then secured consents to assign, which the parties believed at that time were required ("Non-Consent Properties"). Subsequent analysis determined that a portion of these properties, having an allocated value withheld under the Purchase Agreement at closing of $29 million, did not require such consent. Consents now have been received for the remaining properties as to which the allocated value under the Purchase Agreement withheld at closing, was $39 million ("Cured Non-Consent Properties"). We are prepared to pay Calpine the retained portion of the original purchase price, upon our receipt from Calpine of record legal title on these properties, free of any encumbrance, subject to appropriate adjustment for the net revenues through the relevant pre-petition period

related to the Cured Non-Consent Properties, and Calpine's performance of its obligations under the "further assurances" provisions of the Purchase Agreement.

(3) Includes properties subject to additional documentation or completion of ministerial actions by federal or state agencies necessary to perfect legal title issues discovered during routine post-closing analysis after the Acquisition of the domestic oil and natural gas business from Calpine, for which Calpine is contractually obligated to assist in resolving.

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2006 Capital Expenditures

The following table summarizes information regarding development and exploration capital expenditures for the year ended December 31, 2006 (Successor), six months ended December 31, 2005 (Successor), the six months ended June 30, 2005 (Predecessor) and the capital expenditures for the year ended December 31, 2004 (Predecessor).

	Successor		Predecessor	
	Year Ended December 31, 2006	Six Months Ended December 31, 2005	Six Months Ended June 30, 2005	Year Ended December 31, 2004
	(In thousands)			
Capital Expenditures by Operating Area:				
California	$ 39,691	$ 3,933	$ 4,572	$ 8,239
Lobo	51,911	6,775	2,020	8,670
Perdido	25,971	9,268	12,441	18,683
Texas State Waters	13,028	3,023	3,417	-
Other Onshore	10,207	10,831	2,300	8,207
Gulf of Mexico	17,958	9,369	4,556	4,174
Rocky Mountains	15,299	3,035	1,102	-
Mid-Continent	3,371	317	220	300
Leasehold	16,383	9,224	2,617	3,559
New acquisitions	35,105	5,524	-	-
Delay rentals	728	143	443	507
Geological and geophysical/seismic	3,748	5,659	513	199
Total capital expenditures (1)	$ 233,400	$ 67,101	$ 34,201	$ 52,538

(1) Capital expenditures for the year ended December 31, 2006 (Successor) excludes capitalized overhead costs of \$3.4 million, capitalized interest of \$2.1 million and corporate other capitalized costs of \$1.7 million. The six months ended December 31, 2005 (Successor) excludes capitalized interest of \$0.6 million, corporate other capitalized costs of \$1.6 million and capitalized overhead costs of \$1.7 million. Corporate other capitalized costs consist of costs related to IT software/hardware, office furniture and fixtures and license transfer fees. The six-month period ended June 30, 2005 (Predecessor) excludes \$(0.7) million of capitalized interest and \$1.7 million of overhead. The amount for 2004 (Predecessor) excludes \$1.3 million of capitalized interest, \$3.1 million of overhead, \$10.0 million of compressor station and gathering system expense and \$1.4 million for acquisition properties. Our total capital expenditures in 2004 of \$52.5 million, including these exclusions, corresponds to 2004 total capital costs of \$69 million as defined under Statement of Financial Accounting Standards ("SFAS") No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies" in the Supplemental Oil and Gas Disclosure under Item 8 of this report.

Productive Wells and Acreage

The following table sets forth our interest in undeveloped acreage, developed acreage and productive wells in which we own a working interest as of December 31, 2006. Gross represents the total number of acres or wells in which we own a working interest. Net represents our proportionate working interest resulting from our ownership in the gross acres or wells. Productive wells are wells in which we have a working interest and that are capable of producing oil or natural gas.

	Undeveloped Acres (1)		Developed Acres (1)		Productive Wells	
	Gross	Net	Gross	Net	Gross	Net
California	45,364	35,247	47,184	41,695	142	118
Lobo	24,716	21,105	53,519	45,699	359	188
Perdido	4,128	2,073	13,898	6,940	28	14
Texas State Waters	8,860	4,536	2,408	715	2	1
Other Onshore	11,647	7,651	29,797	21,608	161	45
Gulf of Mexico (2)	15,805	9,375	38,695	22,514	4	3
Rocky Mountains	189,511	149,983	8,859	6,160	25	22
Mid-Continent	280	52	2,675	2,561	30	8
	300,311	230,022	197,035	147,892	751	399

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Capital

(1) Includes acreage relating to properties for which legal title was not transferred to us on the original date of the Acquisition because consents to transfer which were believed at that time to be required and had not yet been obtained is included in this table.

(2) Offshore productive wells are based on intervals rather than well bores.

The following table shows our interest in undeveloped acreage as of December 31, 2006, which is subject to expiration in 2007, 2008, 2009, and thereafter.

2007		2008		2009		Thereafter	
Gross	Net	Gross	Net	Gross	Net	Gross	Net
15,379	10,374	25,830	22,929	32,648	25,366	226,454	171,353

Drilling Activity

The following table sets forth the number of gross exploratory and gross development wells drilled in which we participated during the last three fiscal years. The number of wells drilled refers to the number of wells commenced at any time during the respective fiscal year. Productive wells are either producing wells or wells capable of commercial production. At December 31, 2006, we were in the process of drilling six gross wells.

	Gross Wells					
	Exploratory			Development		
	Productive	Dry	Total	Productive	Dry	Total
2006	68.0	15.0	83.0	51.0	8.0	59.0
2005	7.0	5.0	12.0	41.0	3.0	44.0
2004	8.0	2.0	10.0	40.0	2.0	42.0

The following table sets forth, for each of the last three fiscal years, the number of net exploratory and net development wells drilled by us based on our proportionate working interest in such wells.

	Net Wells					
	Exploratory			Development		
	Productive	Dry	Total	Productive	Dry	Total
2006	58.5	10.0	68.5	45.0	6.2	51.2
2005	3.4	3.4	6.8	23.5	3.0	26.5
2004	4.3	1.0	5.3	21.1	2.0	23.1

Marketing and Customers

Pursuant to our natural gas purchase and sales contract with Calpine and its subsidiaries, we are obligated to sell all of the then-existing and future production from our California leases in production as of May 1, 2005, through December 2009, based on market prices. Calpine maintains a right of first refusal for a term of 10 years after the primary term. As of December 31, 2006, this production comprised approximately 40% of our current overall daily equivalent production. Under the terms of our gas purchase and sale contract and spot agreements with Calpine, cash payment for all natural gas volumes that are contractually sold to Calpine on the previous day are deposited into our collateral bank account. If the funds are not deposited one business day in arrears in accordance with our contract, we are not obligated to continue to sell our production to Calpine and these sales can then cease immediately. We would then be in a position to market this natural gas production to other parties. Calpine has 60 days to pay amounts owed to us, at which time we are obligated under the contract to resume natural gas sales to Calpine. We believe that Calpine's bankruptcy will have no significant effect on our ability to sell our natural gas at market prices. Additionally, while we may market our natural gas production, which is not subject to the above mentioned natural gas contract, to parties other than Calpine, an affiliate of Calpine is under contract through June 30, 2007, to provide us administrative services in connection with such marketing efforts.

All of our other production is sold to various purchasers, including Calpine, on a competitive basis.

Major Customers

For the year ended December 31, 2006, the Company had two major customers, which accounted for approximately 60% of the Company's consolidated annual revenue. Calpine Energy Services ("CES") was one of the major customers and accounted for approximately 45% of the Company's consolidated annual revenue. Total Gas and Power was the other major customer.

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Competition

The oil and natural gas industry is highly competitive, and we compete with a substantial number of other companies that have greater resources. Many of these companies explore for, produce and market oil and natural gas, carry on refining operations and market the resultant products on a worldwide basis. The primary areas in which we encounter substantial competition are in locating and acquiring desirable leasehold acreage for our drilling and development operations, locating and acquiring attractive producing oil and natural gas properties, and obtaining purchasers and transporters of the oil and natural gas we produce. There is also competition between producers of oil and natural gas and other industries producing alternative energy and fuel. Furthermore, competitive conditions may be substantially affected by various forms of energy legislation and/or regulation considered from time to time by the federal, state and local government; however, it is not possible to predict the nature of any such legislation or regulation that may ultimately be adopted or its effects upon our future operations. Such laws and regulations may, however, substantially increase the costs of exploring for, developing or producing natural gas and oil and may prevent or delay the commencement or continuation of a given operation. The effect of these risks cannot be accurately predicted.

Seasonal Nature of Business

Generally, but not always, the demand for natural gas decreases during the summer months and increases during the winter months. Seasonal anomalies such as mild winters or abnormally hot summers sometimes lessen this fluctuation. In addition, certain natural gas users utilize natural gas storage facilities and purchase some of their anticipated winter requirements during the summer. This can also lessen seasonal demand fluctuations. Seasonal weather conditions and lease stipulations can limit our drilling and producing activities and other oil and natural gas operations in certain areas of the Rocky Mountain region. These seasonal anomalies can increase competition for equipment, supplies and personnel during the spring and summer months, which could lead to shortages and increase costs or delay our operations.

Regulation

The oil and natural gas industry in the United States is subject to extensive regulation by federal, state and local authorities. We hold onshore and offshore federal leases involving the United States Department of Interior (the Bureau of Land Management, the Bureau of Indian Affairs and the Minerals Management Service). At the federal level, various federal rules, regulations and procedures apply, including those issued by the United States Department of Interior as noted above, and the United States Department of Transportation (U.S. Coast Guard and Office of Pipeline Safety). At the state and local level, various agencies and commissions regulate drilling, production and midstream activities. These federal, state and local authorities have various permitting, licensing and bonding requirements. Varied remedies are available for enforcement of these federal, state and local rules, regulations and procedures, including fines, penalties, revocation of permits and licenses, actions affecting the value of leases, wells or other assets, and suspension of production. As a result, there can be no assurance that we will not incur liability for fines and penalties or otherwise subject us to the various remedies as are available to these federal, state and local authorities. However, we believe that we are currently in material compliance with these federal, state and local rules, regulations and procedures.

Transportation and Sale of Natural Gas. The Federal Energy Regulatory Commission ("FERC") regulates interstate natural gas pipeline transportation rates and service conditions. Although the FERC does not regulate natural gas producers such as us, the agency's actions are intended to foster increased competition within all phases of the natural gas industry. To date, the FERC's pro-competition policies have not materially affected our business or operations. It is unclear what impact, if any, future rules or increased competition within the natural gas industry will have on our natural gas sales efforts.

The FERC, the United States Congress or state regulatory agencies may consider additional proposals or proceedings that might affect the natural gas industry. We cannot predict when or if these proposals will become effective or any effect they may have on our operations. We do not believe, however, that any of these proposals will affect us any differently than other natural gas producers with which we compete.

Regulation of Production. Oil and natural gas production is regulated under a wide range of federal, state and municipal (or other local) statutes, rules, orders and regulations. Federal, state and municipal statutes and regulations require permits for drilling operations, drilling bonds and reports concerning operations. The states in which we own and operate properties have regulations governing conservation matters, including provisions for the unitization or pooling of oil and natural gas properties, the establishment of maximum rates of production from oil and natural gas wells and the regulation of the spacing and plugging and abandonment of wells. Many states also restrict production to the market demand for oil and gas, and several states have indicated interest in revising applicable regulations. These regulations limit the amount of oil and gas we can produce from our wells and limit the number of wells or the locations at which we can drill. Also, each state generally imposes an ad valorem, production or severance tax with respect to production and sale of oil, natural gas and natural gas liquids within its jurisdiction.

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U.S. Minerals Management Services of the Department of the Interior. The MMS has broad authority to regulate our oil and natural gas operations on offshore leases in federal waters. It must approve and grant permits in connection with our drilling and development plans. Additionally, the MMS has promulgated regulations requiring offshore production facilities to meet stringent engineering and construction specifications restricting the flaring or venting of natural gas, governing the plugging and abandonment of wells and controlling the removal of production facilities. Under certain circumstances, the MMS may suspend or terminate any of our operations on federal leases, and has proposed regulations that would permit it to expel unsafe operators from offshore operations. Delays in the approval of plans and issuance of permits by the MMS because of staffing, economic, environmental or other reasons could adversely affect our operations. The MMS has also established rules governing the calculation of royalties and the valuation of oil and natural gas produced from federal onshore and offshore leases and regulations regarding deductible costs.

Environmental Regulations. Processes involved in the drilling, construction, extraction and transportation of oil and natural gas in the exploration and production industry are subject to extensive operating rules and regulations that have been promulgated by federal, state and local authorities with the intent of conserving natural resources, preservation of the environment and protection of human health. Environmental regulations affecting us prohibit or control the emitting or discharge of regulated pollutants into the atmosphere, underground sources of drinking water, ground water supplies, surface waters of the United States, or to unprotected surface soils on or in the vicinity of our operations. The environmental statutes provide for sensitive habitat, endangered species, wetlands loss and waste management practices. The standards in many cases require a lengthy and complex process of obtaining licenses, permits and approvals from federal, state and local agencies. Inherent in the environmental legal system affecting our business are the following primary compliance obligations which often require costly precautionary measures or lend us to serious enforcement consequences:

- Notification requirements
- Point of discharge or “Waste End” controls
- Process oriented controls and pollution prevention
- Regulation of activities to protect resources, species or ecological amenities
- Safe transportation requirements
- Response and remediation requirements
- Compensation requirements.

The environmental regulations provide for criminal prosecution of responsible corporate officials under certain circumstances. In addition, the environmental regulations also provide for civil enforcement actions in certain circumstances.

The environmental laws with their implementing regulations with the most significant impact on the oil and natural gas exploration and production industry include the following:

- Clean Air Act (“CAA”)
- Clean Water Act (“CWA”)

- Comprehensive Environmental Response, Compensation & Liability Act (“CERCLA”)
- National Environmental Policy Act (“NEPA”)
- Oil Pollution Act of 1990 (“OPA’90”)
- Resource Conservation & Recovery Act (“RCRA”)
- Safe Drinking Water Act
- Superfund Amendments & Reauthorization Act (“SARA”)

Environmental laws and regulations are subject to change, and we are unable to predict the ongoing cost of complying with them or their future impact on our operations. A violation of environmental laws and regulations and any related permits may result in administrative, civil or criminal penalties, injunctions and delays. Discharge of hydrocarbons or hazardous substances into the environment to the extent the event is not insured, may result in substantial expense, including both the cost to comply with the applicable laws and regulations and claims made by neighboring landowners and other third parties for personal injury and property damage.

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We believe that we are currently in substantial compliance with the requirements of these statutes and related state and local laws and regulations, and that we hold all necessary and up-to-date permits, registrations and other authorizations to the extent they are required by our operations under such laws.

Occupational Safety & Health Act ("OSHA"). The Williams-Steiger Occupational Safety and Health Act of 1970 requires, in part, that every employer covered under OSHA furnish its employees a place of employment which is free from recognized hazards that are causing or are likely to cause death or serious physical harm to its employees. OSHA also requires that employers comply with occupational safety and health standards promulgated under OSHA, and that employees comply with standards, rules, regulations and orders issued under the Act which are applicable to their own actions and conduct. OSHA authorizes the Department of Labor to conduct inspections, and to issue citations and proposed penalties for alleged violations. OSHA, under section 20(b), also authorizes the Secretary of Health, Education, and Welfare to conduct inspections and to question employers and employees in connection with research and other related activities. OSHA contains provisions for adjudication of violations, periods prescribed for the abatement of violations, and proposed penalties by the Occupational Safety and Health Review Commission, if contested by an employer or by an employee or authorized representative of employees, and for judicial review.

Insurance Matters

As is common in the oil and natural gas industry, we do not insure fully against all risks associated with our business either because such insurance is not available or because premium costs are considered prohibitive. A loss not fully covered by insurance could have a materially adverse effect on our financial position, results of operations or cash flows. In analyzing our operations and insurance needs, and in recognition that we have a large number of individual well locations with varied geographical distribution, we compared premium costs to the likelihood of material loss of production. Based on this analysis, we have elected, at this time, not to carry loss of production or business interruption insurance for our operations.

Employees

As of March 5, 2007, we have 135 full time employees. We also contract for the services of independent consultants involved in land, regulatory accounting, financial and other disciplines as needed. None of our employees are represented by labor unions or covered by any collective bargaining agreement. We believe that our relations with our employees are satisfactory.

Access to Company Reports

For further information pertaining to us, you may inspect without charge at the public reference facilities of the SEC at 100 F Street, NE, Room 1580, Washington, D.C. 20549 any of our filings with the SEC. Copies of all or any portion of the documents may be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains a web site that contains reports, proxy and information statements and other information that is filed electronically with the SEC. The web site can be accessed at *www.sec.gov*.

Corporate Governance Matters

Our website is *http://www.rosettaresources.com.* All corporate filings with the SEC can be found on our website, as well as other information related to our business. Under the Corporate Governance tab you can find copies of our Code of Business Conduct and Ethics, our Nominating and Corporate Governance Committee Charter, our Audit Committee Charter, and our Compensation Committee Charter.

Item 1A. Risk Factors

Calpine's bankruptcy filing may adversely affect us in several respects.

Calpine, its creditors or interest holders may challenge the fairness of some or all of the Acquisition.

Five and one-half months after the Acquisition, Calpine and certain of its subsidiaries (the "Debtors") filed for protection under the federal bankruptcy laws in the Bankruptcy Court on December 20, 2005 (the "Petition Date"). Calpine or its Bankruptcy estate may bring an action under the Bankruptcy Code or relevant state fraudulent conveyance laws asserting that Calpine's transfer of its domestic oil and natural gas business to us (as either the alleged initial transferee or the immediate or mediate transferee from the initial transferee) should be voided or set aside as a fraudulent transfer or, alternatively, entitles Calpine's estate monetary relief to the extent Rosetta is found not to have paid reasonably equivalent value. To prevail in such a legal action, Calpine, its creditors or interest holders would be required to prove that Calpine either:

- Transferred its domestic oil and natural gas business to us with the intent of hindering, delaying or defrauding its current or future creditors; or

- As of July 7, 2005 (the date of the closing of the Acquisition), (a) received less than reasonably equivalent value for the business, and (b) was insolvent, became insolvent as a result of such transfer, was engaged in a business or transaction or was about to engage in a business or transaction for which any property remaining was unreasonably small, or intended to incur or believed it would incur debts that would be beyond its ability to pay as such debts matured.

Our primary defense against such a legal challenge rests on the extensive negotiations leading up to, and the market pricing mechanisms incorporated within the terms and procedure of the Acquisition. Nonetheless, if after a trial on the merits, the Bankruptcy Court was to determine that the Debtors have met their burden of proof, it could void the transfer or take other actions against us, including (i) setting aside the Acquisition and returning our purchase price and give us a first lien on all the properties and assets we purchased in the Acquisition or (ii) sustaining the Acquisition subject to our being required to pay the Debtors the amount, if any, by which the fair value of the business transferred, as determined by the Bankruptcy Court as of July 7, 2005, exceeded the purchase price determined and paid in July 2005. If the Bankruptcy Court should so rule, a setting aside of the Acquisition would be materially detrimental to us in that substantially all our properties conveyed at the time of the Acquisition would be returned to Calpine, subject to our right (as a good faith transferee) to retain a lien in our favor to secure the return of the purchase price we paid for the properties. Additionally, if the Bankruptcy Court should so rule, any requirement to pay an increased purchase price could adversely affect us depending on the amount we might be required to pay. See Item 3. Legal Proceedings for further information regarding the Calpine bankruptcy.

The bankruptcy proceeding may prevent, frustrate or delay our ability to receive record legal title to certain properties originally determined to be Non-Consent Properties which we are entitled to receive under the Purchase Agreement.

At the closing of the Acquisition, Calpine agreed to sell but retained legal title to certain domestic oil and natural gas properties, subject to obtaining various third party consents or waivers of preferential purchase rights, which the parties believe at the time were required, in order to effect transfer of legal title. In July 2005, as part of the transactions undertaken in connection with closing the Acquisition, we accepted possession of and have since been operating all of the properties for which Calpine retained record legal title. We withheld approximately $75 million from the aggregate purchase price, which was the allocated dollar amount under the Purchase Agreement for the remaining properties. Subsequent to the closing of the Acquisition, with the exception of the properties subject to the preferential right to purchase, we obtained substantially all of the consents to assign for all of these remaining properties for which consents were actually required. Prior to the Calpine bankruptcy, we were prepared to consummate the assignments of legal title for these remaining properties, except those subject to properly executed preferential rights to purchase. The SEC PV-10 value of these properties at December 31, 2005 was approximately $72.4 million pretax. Based on our internal calculations, we estimate the SEC PV-10 value of these properties at current market prices at December 31, 2006 to be approximately $53.0 million pretax. We are prepared to pay Calpine the retained portion of the original purchase price, approximately $68 million, and approximately $11 million in other true-up payment obligations, all upon our receipt from Calpine of record legal title, free of any encumbrances, for that portion of these properties which are the Non-Consent Properties, subject to appropriate adjustment for the net revenues and expenses through December 15, 2005 and Calpine's performance of its obligations under the "further assurances" provisions of the Purchase Agreement. If the assignment of any remaining properties (including any leases) does not occur, the portion of the purchase price we held back pending consent or waiver will be retained by us and will be available to us for general corporate purposes.

The bankruptcy proceeding may prevent, frustrate or delay our ability to receive corrective documentation from Calpine for certain properties that we bought from Calpine and paid for, in cases where Calpine delivered incomplete documentation, including documentation related to certain ministerial governmental approvals.

Certain of the properties we purchased from Calpine and paid Calpine for on July 7, 2005, require certain additional documentation, depending on the particular facts and circumstances surrounding the particular properties involved, such documentation to be delivered by Calpine to quiet title related to our ownership of these properties. Certain of these properties are subject to ministerial governmental action approving us as qualified assignee and operator, even though in most cases there had been a conveyance by Calpine and release of mortgages and liens by Calpine's creditors. For certain other properties, the documentation delivered by Calpine at closing was incomplete. While we remain hopeful that Calpine will continue to work cooperatively with us to secure these ministerial governmental approvals and accomplish the curative corrections for all of these properties for which we paid Calpine for, all of the same being covered, we believe, by the further assurances provision of the Purchase Agreement, the exact details for each property involved and how, when and if this will be able to be secured or accomplished continue to remain uncertain at this stage of Calpine's bankruptcy.

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Additionally, on June 29, 2006, Calpine filed a Section 365 motion in connection with its pending bankruptcy proceeding seeking entry of an order authorizing Calpine to assume certain oil and natural gas leases which Calpine previously sold or agreed to sell to us in the Acquisition, to the extent those leases constitute "unexpired leases of non-residential real property" and were not fully transferred to us at the time of Calpine's filing for bankruptcy. According to this motion, Calpine filed it to avoid the automatic forfeiture of any interest it might have in these leases by operation of a statutory deadline. Calpine's motion did not request that the Bankruptcy Court determine whether these properties belong to us or to Calpine. Generally, oil and gas leases are regarded as real property and not leases of real property despite their being called leases. If the Bankruptcy Court were to later conclude that the oil and natural gas leases are "unexpired leases of non-residential real property," and that we had no interest in them, we may be required to take further action or pay further consideration to complete the assignments of these interests or Calpine could retain the leases. In light of Calpine's obligations under the Purchase Agreement and rights afforded purchasers of real property, we would oppose any such request or effort. Any failure by Calpine to complete the corrective action necessary to remove title deficiencies with respect to certain of these properties, including decision of the Bankruptcy Court not to require Calpine to deliver corrective documentation or to require us to pay additional consideration, could result in a material adverse effect on our results of operations or financial condition if we are not able to receive any offsetting refund of the portion of the purchase price attributable to those properties or if the amount of additional consideration we are required to pay is material.

We have expended and may continue to expend significant resources in connection with Calpine's bankruptcy.

We have expended and may continue to expend significant resources in connection with Calpine's bankruptcy. These resources include our increased costs for lawyers, consultant experts and related expenses, as well as lost opportunity costs associated with our dedicating internal resources to these matters. If we continue to expend significant resources and our management is distracted from the operational matters by the Calpine bankruptcy, our business, results of operations, financial position or cash flows could be adversely affected.

Oil and natural gas prices are volatile, and a decline in oil and natural gas prices would significantly affect our financial results and impede our growth.

Our revenue, profitability and cash flow depend substantially upon the prices and demand for oil and natural gas. The markets for these commodities are volatile and even relatively modest drops in prices can significantly affect our financial results and impede our growth. Prices for oil and natural gas fluctuate widely in response to relatively minor changes in the supply and demand for oil and natural gas, market uncertainty and a variety of additional factors beyond our control, such as:

- Domestic and foreign supply of oil and gas;
- Price and quantity of foreign imports;
- Actions of the Organization of Petroleum Exporting Countries and state-controlled oil companies relating to oil price and production controls;
- Domestic and foreign governmental regulations;
- Political conditions in or affecting other oil producing and natural gas producing countries, including the current conflicts in the Middle East and conditions in South America and Russia;
- Weather conditions and natural disasters;

- Technological advances affecting oil and natural gas consumption;
- Overall U.S. and global economic conditions; and
- Price and availability of alternative fuels.

Further, oil and natural gas prices do not necessarily fluctuate in direct relationship to each other. Because the majority of our estimated proved reserves are natural gas reserves, our financial results are more sensitive to movements in natural gas prices. Lower oil and natural gas prices may not only decrease our revenues on a per unit basis but also may reduce the amount of oil and natural gas that we can produce economically. Thus a significant reduction in commodity prices may result in our having to make substantial downward adjustments to our estimated proved reserves and could have a material adverse effect on our financial condition, results of operations and cash flows.

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Development and exploration drilling activities do not ensure reserve replacement and thus our ability to produce revenue.

Development and exploration drilling and strategic acquisitions are the main methods of replacing reserves. However, development and exploration drilling operations may not result in any increases in reserves for various reasons. Development and exploration drilling operations may be curtailed, delayed or cancelled as a result of:

- Lack of acceptable prospective acreage;
- Inadequate capital resources;
- Weather conditions and natural disasters;
- Title problems;
- Compliance with governmental regulations;
- Mechanical difficulties; and
- Availability of equipment.

Counterparty credit default could have an adverse effect on us.

Our revenues are generated under contracts with various counterparties. Results of operations would be adversely affected as a result of non-performance by any of these counterparties of their contractual obligations under the various contracts. A counterparty's default or non-performance could be caused by factors beyond our control such as a counterparty experiencing credit default. A default could occur as a result of circumstances relating directly to the counterparty, or due to circumstances caused by other market participants having a direct or indirect relationship with the counterparty. Defaults by counterparties may occur from time to time, and this could negatively impact our results of operations, financial position and cash flows. Calpine's recent bankruptcy could result in the failure of Calpine to continue purchasing natural gas from us under our natural gas purchase and sale agreements with Calpine discussed below.

We sell a significant amount of our production to one customer.

In connection with the Acquisition, we entered into a natural gas purchase and sale contract with Calpine that obligates us to sell all of the then-existing and future production from our California leases in production as of May 1, 2005 through December 31, 2009 based on market prices. Calpine maintains a right of first refusal for a term of 10 years after the primary term. As of December 31, 2006, this production comprised approximately 40% of our current overall production based on an equivalent basis. Calpine's recent bankruptcy could result in failure of Calpine to continue purchasing natural gas from us. Additionally, under separate monthly spot agreements, we may sell our natural gas production, not subject to the term contract to Calpine, which could increase our credit exposure to Calpine. Under the terms of our natural gas purchase and sale contract and spot agreements with Calpine, all natural gas volumes that are contractually sold to Calpine are collateralized by Calpine making margin payments one business day in arrears to our collateral account equal to the previous day's natural gas sales. In the event of a default by Calpine, we could be exposed to the loss of up to four days of natural gas sales revenue under the contract, which at prices and volumes in effect as of December 31, 2006 would be approximately $2.5 million.

Unless we replace our oil and natural gas reserves, our reserves and production will decline.

Our future oil and natural gas production depends on our success in finding or acquiring additional reserves. If we fail to replace reserves through drilling or acquisitions, our level of production and cash flows will be affected adversely. In general, production from oil and natural gas properties declines as reserves are depleted, with the rate of decline depending on reservoir characteristics. Our total proved reserves decline as reserves are produced. Our ability to make the necessary capital investment to maintain or expand our asset base of oil and natural gas reserves would be impaired to the extent cash flow from operations is reduced and external sources of capital become limited or unavailable. We may not be successful in exploring for, developing or acquiring additional reserves.

We will require additional capital to fund our future activities. If we fail to obtain additional capital, we may not be able to implement fully our business plan, which could lead to a decline in reserves.

Future projects and acquisitions may depend on our ability to obtain financing beyond our cash flow from operations. We will finance our business plan and operations primarily with internally generated cash flow, bank borrowings, entering into exploratory arrangements with other parties and publicly or privately raised equity. In the future, we will require substantial capital to fund our business plan and operations. Sufficient capital may not be available on acceptable terms or at all. If we cannot obtain additional capital resources, we may curtail our drilling, development and other activities or be forced to sell some of our assets on unfavorable terms.

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The terms of our credit facilities contain a number of restrictive and financial covenants that limit our ability to pay dividends. If we are unable to comply with these covenants, our lenders could accelerate the repayment of our indebtedness.

The terms of our credit facilities subject us to a number of covenants that impose restrictions on us, including our ability to incur indebtedness and liens, make loans and investments, make capital expenditures, sell assets, engage in mergers, consolidations and acquisitions, enter into transactions with affiliates, enter into sale and leaseback transactions, change our lines of business and pay dividends on our common stock. We will also be required by the terms of our credit facilities to comply with financial covenant ratios. A more detailed description of our credit facilities is included in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" and the footnotes to the Consolidated/Combined Financial Statements.

A breach of any of the covenants imposed on us by the terms of our indebtedness, including the financial covenants under our credit facilities, could result in a default under such indebtedness. In the event of a default, the lenders for our revolving credit facility could terminate their commitments to us, and they and the lenders of our second lien term loan could accelerate the repayment of all of our indebtedness. In such case, we may not have sufficient funds to pay the total amount of accelerated obligations, and our lenders under the credit facilities could proceed against the collateral securing the facilities. Any acceleration in the repayment of our indebtedness or related foreclosure could adversely affect our business.

Properties we acquire may not produce as expected, and we may be unable to determine reserve potential, identify liabilities associated with the properties or obtain protection from sellers against such liabilities.

We continually review opportunities to acquire producing properties, undeveloped acreage and drilling prospects; however, such reviews are not capable of identifying all potential conditions. Generally, it is not feasible to review in depth every individual property involved in each acquisition. Ordinarily, we will focus our review efforts on higher value properties or properties with known adverse conditions and will sample the remainder.

However, even a detailed review of records and properties may not necessarily reveal existing or potential problems or permit a buyer to become sufficiently familiar with the properties to assess fully their condition, any deficiencies, and development potential. Inspections may not always be performed on every well, and environmental problems, such as ground water contamination are not necessarily observable even when an inspection is undertaken.

Our exploration and development activities may not be commercially successful.

Exploration activities involve numerous risks, including the risk that no commercially productive oil or natural gas reservoirs will be discovered. In addition, the future cost and timing of drilling, completing and producing wells is often uncertain. Furthermore, drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

- Unexpected drilling conditions; pressure or irregularities in formations; equipment failures or accidents;
- Adverse weather conditions, including hurricanes, which are common in the Gulf of Mexico during certain times of the year; compliance with governmental regulations; unavailability or high cost of drilling rigs, equipment or labor;
- Reductions in oil and natural gas prices; and
- Limitations in the market for oil and natural gas.

Our decisions to purchase, explore, develop and exploit prospects or properties depend in part on data obtained through geophysical and geological analyses, production data and engineering studies, the results of which are often uncertain. Even when used and properly interpreted, 3-D seismic data and visualization techniques only assist geoscientists in identifying subsurface structures and hydrocarbon indicators. They do not allow the interpreter to know conclusively if hydrocarbons are present or producible economically. In addition, the use of 3-D seismic and other advanced technologies requires greater pre-drilling expenditures than traditional drilling strategies. Because of these factors, we could incur losses as a result of exploratory drilling expenditures. Poor results from exploration activities could have a material adverse effect on our future cash flows, results of operations and financial position.

Numerous uncertainties are inherent in our estimates of oil and natural gas reserves and our estimated reserve quantities and present value calculations may not be accurate. Any material inaccuracies in these reserve estimates or underlying assumptions will affect materially the estimated quantities and present value of our reserves.

Estimates of proved oil and natural gas reserves and the future net cash flows attributable to those reserves are prepared by independent petroleum engineers and geologists. There are numerous uncertainties inherent in estimating quantities of proved oil and natural gas reserves and cash flows attributable to such reserves, including factors beyond our control and that of our engineers. Reserve engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact manner. The accuracy of an estimate of quantities of reserves, or of cash flows attributable to such reserves, is a function of the available data, assumptions regarding future oil and natural gas prices, expenditures for future development and exploration activities, engineering and geological interpretation and judgment. Additionally, reserves and future cash flows may be subject to material downward or upward revisions, based upon production history, development and exploration activities and prices of oil and natural gas. Actual future production, revenue, taxes, development expenditures, operating expenses, underlying information, quantities of recoverable reserves and the value of cash flows from such reserves may vary significantly from the assumptions and underlying information set forth herein. In addition, different reserve engineers may make different estimates of reserves and cash flows based on the same available data. The present value of future net revenues from our proved reserves referred to in this Report is not necessarily the actual current market value of our estimated oil and natural gas reserves. In accordance with SEC requirements, we base the estimated discounted future net cash flows from our proved reserves on fixed prices and costs as of the date of the estimate. Actual future prices and costs fluctuate over time and may differ materially from those used in the present value estimate. In addition, discounted future net cash flows are estimated assuming royalties to the MMS, royalty owners and other state and federal regulatory agencies with respect to our affected properties, and will be paid or suspended during the life of the properties based upon oil and natural gas prices as of the date of the estimate. Since actual future prices fluctuate over time, royalties may be required to be paid for various portions of the life of the properties and suspended for other portions of the life of the properties.

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The timing of both the production and expenses from the development and production of oil and natural gas properties will affect both the timing of actual future net cash flows from our proved reserves and their present value. In addition, the 10% discount factor that we use to calculate the net present value of future net cash flows for reporting purposes in accordance with the SEC's rules may not necessarily be the most appropriate discount factor. The effective interest rate at various times and the risks associated with our business or the oil and natural gas industry, in general, will affect the appropriateness of the 10% discount factor in arriving at an accurate net present value of future net cash flows.

We are subject to the full cost ceiling limitation which may result in a write-down of our estimated net reserves.

Under the full cost method, we are subject to quarterly calculations of a "ceiling" or limitation on the amount of our oil and gas properties that can be capitalized on our balance sheet. If the net capitalized costs of our oil and gas properties exceed the cost center ceiling, we are subject to a ceiling test write-down of our estimated net reserves to the extent of such excess. If required, it would reduce earnings and impact stockholders' equity in the period of occurrence and result in lower amortization expense in future periods. The discounted present value of our proved reserves is a major component of the ceiling calculation and represents the component that requires the most subjective judgments. However, the associated hedge adjusted market prices of oil and gas reserves that are included in the discounted present value of the reserves do not require judgment. The ceiling calculation dictates that prices and costs in effect as of the last day of the quarter are held constant. However, we may not be subject to a write-down if prices increase subsequent to the end of a quarter in which a write-down might otherwise be required. The risk that we will be required to write down the carrying value of oil and natural gas properties increases when natural gas and crude oil prices are depressed or volatile. In addition, write-down of proved oil and natural gas properties may occur if we experience substantial downward adjustments to our estimated proved reserves or if purchasers cancel long-term contracts for our natural gas production. As expense recorded in one period may not be reversed in a subsequent period event though higher natural gas and crude oil prices may have increased the ceiling applicable in the subsequent period.

We are subject to complex government regulation that could adversely affect our operations.

Our activities are subject to complex and stringent environmental and other governmental laws and regulations. The exploration and production of oil and natural gas requires numerous permits, approvals and certificates from appropriate federal, state and local governmental agencies, including state and local agencies in California, whose regulations typically are more stringent than in other states or localities, as well as compliance with environmental protection legislation and other regulations. We remain subject to a varied and complex body of laws and regulations that both public officials and private individuals may seek to enforce. Existing laws and regulations are routinely revised or reinterpreted, and together with new laws and regulations may impact us and have a negative effect on our business and results of operations. We may be unable to obtain all necessary licenses, permits, approvals and certificates for proposed projects. Intricate and changing environmental and other regulatory requirements may necessitate substantial expenditures to obtain and maintain permits. If a project is unable to function as planned due to changing requirements or local opposition, it may create expensive delays, extended periods of non-operation or significant loss of value in a project.

Our business is subject to federal, state and local laws and regulations as interpreted by governmental agencies and other bodies, including those in California, vested with authority over the exploration, development, production and transportation of oil and natural gas, including environmental and safety matters. Existing laws and regulations are routinely changed which could increase costs of compliance and costs of operating drilling equipment, or otherwise significantly limit drilling activity.

Under certain circumstances, the MMS may require that our operations on federal leases be suspended or terminated. These circumstances include our failure to pay royalties or our failure to comply with safety and environmental regulations. The requirements imposed by these laws and regulations are frequently changed and subject to new interpretations, and if such were to occur, could negatively impact our results of operations and cash flows.

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Our business requires technical expertise, specialized knowledge and training and a high degree of management experience.

Our success is largely dependent on the skills, experience and efforts of our employees. The loss of the services of one or more members of our senior management or of numerous employees with critical skills could have a negative effect on our business, financial conditions and results of operations and future growth.

Our results are subject to commodity price fluctuations related to seasonal and market conditions and reservoir and production risks.

Our quarterly operating results have fluctuated in the past and could be negatively impacted in the future as a result of a number of factors, including:

- Seasonal variations in oil and natural gas prices;
- Variations in levels of production; and
- The completion of exploration and production projects.

The ultimate outcome of the legal proceedings relating to our activities cannot be predicted. Any adverse determination could have a material adverse effect on our financial condition, results of operations or cash flows.

Operation of our properties has generated various litigation matters arising out of the normal course of business. In connection with the transfer and assumption agreement with Calpine, we generally assumed liabilities arising from our activities from and after the Acquisition, including defense of future litigation and claims involving Calpine's domestic oil and natural gas reserve properties conveyed in the Acquisition, other than certain litigation that Calpine and its subsidiaries retained liability or agreed to indemnify the Company by agreement. Calpine's bankruptcy may affect its obligations for the retained liabilities and claims. The ultimate outcome of claims and litigation relating to our activities cannot presently be determined, nor can the liability that may potentially result from a negative outcome be reasonably estimated at this time for every case. The liability we may ultimately incur with respect to any one of these matters in the event of a negative outcome may be in excess of amounts currently accrued with respect to such matters and, as a result, these matters may potentially be material to our financial condition, results of operations or cash flows.

Market conditions or transportation impediments may hinder our access to oil and natural gas markets or delay our production.

Market conditions, the unavailability of satisfactory oil and natural gas processing and transportation or the remote location of certain of our drilling operations may hinder our access to oil and natural gas markets or delay our production. The availability of a ready market for our oil and natural gas production depends on a number of factors, including the demand for and supply of oil and natural gas and the proximity of reserves to pipelines or trucking and terminal facilities. In the Gulf of Mexico operations, the availability of a ready market depends on the proximity of and our ability to tie into existing production platforms owned or operated by others and the ability to negotiate commercially satisfactory arrangements with the owners or operators. We may be required to shut in natural gas wells or delay initial production for lack of a market or because of inadequacy or unavailability of natural gas pipelines or gathering system capacity. When that occurs, we are unable to realize revenue from those wells until the production can be tied to a gathering system. This can result in considerable delays from the initial discovery of a reservoir to the actual production of the oil and natural gas and realization of revenues.

Competition in the oil and natural gas industry is intense, and many of our competitors have resources that are greater than ours.

We operate in a highly competitive environment for acquiring prospects and productive properties, marketing oil and natural gas and securing equipment and trained personnel. Many of our competitors, major and large independent oil and natural gas companies, possess and employ financial, technical and personnel resources substantially greater than our resources. Those companies may be able to develop and acquire more prospects and productive properties than our financial or personnel resources permit. Our ability to acquire additional prospects and discover reserves in the future will depend on our ability to evaluate and select suitable properties and consummate transactions in a highly competitive environment. Also, there is substantial competition for capital available for investment in the oil and natural gas industry. Larger competitors may be better able to withstand sustained periods of unsuccessful drilling and absorb the burden of changes in laws and regulations more easily than we can, which would adversely affect our competitive position. We may not be able to compete successfully in the future in acquiring prospective reserves, developing reserves, marketing hydrocarbons, attracting and retaining quality personnel and raising additional capital.

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Operating hazards, natural disasters or other interruptions of our operations could result in potential liabilities, which may not be fully covered by our insurance.

The oil and natural gas business involves certain operating hazards such as:

- Well blowouts;
- Cratering;
- Explosions;
- Uncontrollable flows of oil, natural gas or well fluids;
- Fires;
- Hurricanes, tropical storms, earthquakes, mud slides, and flooding;
- Pollution; and
- Releases of toxic gas.

The occurrence of one of the above may result in injury, loss of life, property damage, suspension of operations, environmental damage and remediation and/or governmental investigations and penalties.

In addition, our operations in California are especially susceptible to damage from natural disasters such as earthquakes and fires and involve increased risks of personal injury, property damage and marketing interruptions. Any of these operating hazards could cause serious injuries, fatalities or property damage, which could expose us to liabilities. The payment of any of these liabilities could reduce, or even eliminate, the funds available for exploration, development, and acquisition, or could result in a loss of our properties. Our insurance policies provide limited coverage for losses or liabilities relating to pollution, with broader coverage for sudden and accidental occurrences. Our insurance might be inadequate to cover our liabilities. For example, we are not fully insured against earthquake risk in California because of high premium costs. Insurance covering earthquakes or other risks may not be available at premium levels that justify its purchase in the future, if at all. In addition, we are subject to energy package insurance coverage limitations related to any single named windstorm. The insurance market in general and the energy insurance market in particular have been difficult markets over the past several years. Insurance costs are expected to continue to increase over the next few years and we may decrease coverage and retain more risk to mitigate future cost increases. If we incur substantial liability and the damages are not covered by insurance or are in excess of policy limits, or if we incur a liability at a time when we are not able to obtain liability insurance, then our business, results of operations, financial condition, and cash flows could be materially adversely affected. Because of the expense of the associated premiums and the perception of risk, we do not have any insurance coverage for any loss of production as may be associated with these operating hazards.

Environmental, health, and safety liabilities could adversely affect our financial condition.

The oil and natural gas business is subject to environmental, health and safety hazards, such as oil spills, natural gas leaks and ruptures and discharges of petroleum products and hazardous substances, and historic disposal activities. These hazards could expose us to material liabilities for property damages, personal injuries or other environmental, health and safety harms, including costs of investigating and remediating contaminated properties. In addition, we also may be liable for environmental damages caused by the previous owners or operators of properties we have purchased or are currently operating. A variety of federal, state and local laws and regulations govern the environmental aspects of our business and impose strict requirements for, among other things:

- Well drilling or workover, operation and abandonment;
- Waste management;
- Land reclamation;
- Financial assurance under the Oil Pollution Act of 1990; and
- Controlling air, water and waste emissions.

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Any noncompliance with these laws and regulations could subject us to material administrative, civil or criminal penalties or other liabilities. Additionally, our compliance with these laws may, from time to time, result in increased costs to our operations or decreased production, and may affect our costs of acquisitions. We are unable to predict the ultimate cost of complying with these regulations.

In addition, environmental laws may, in the future, cause a decrease in our production or cause an increase in our costs of production, development or exploration. Pollution and similar environmental risks generally are not fully insurable.

Some of our California properties have been in operation for a substantial length of time, and current or future local, state and federal environmental and other laws and regulations may require substantial expenditures to remediate the properties or to otherwise comply with these laws and regulations. A variety of existing laws, rules and guidelines govern activities that can be conducted on our properties and other existing or future laws, rules and guidelines could prohibit or limit our operations and our planned activities for properties.

Under our Purchase Agreement with Calpine, other than certain retained claims, we are responsible for environmental claims prior to the Acquisition and we may not have indemnification from Calpine related to those claims.

Our acquisition strategy could fail or present unanticipated problems for our business in the future, which could adversely affect our ability to make acquisitions or realize anticipated benefits of those acquisitions.

Our growth strategy includes acquiring oil and natural gas businesses and properties if favorable economics and strategic objectives can be served. We may not be able to identify suitable acquisition opportunities or finance and complete any particular acquisition successfully.

Furthermore, acquisitions involve a number of risks and challenges, including:

- Division of management’s attention;
- The need to integrate acquired operations;
- Potential loss of key employees of the acquired companies;
- Potential lack of operating experience in a geographic market of the acquired business; and
- An increase in our expenses and working capital requirements.

Any of these factors could adversely affect our ability to achieve anticipated levels of cash flows from the acquired businesses and properties or realize other anticipated benefits of those acquisitions.

We are vulnerable to risks associated with operating in the Gulf of Mexico.

Our operations and financial results could be significantly impacted by conditions in the Gulf of Mexico because we explore and produce extensively in that area. As a result of this activity, we are vulnerable to the risks associated with operating in the Gulf of Mexico, including those relating to:

- Adverse weather conditions and natural disasters;
- Oil field service costs and availability;
- Compliance with environmental and other laws and regulations;
- Remediation and other costs resulting from oil spills or releases of hazardous materials; and
- Failure of equipment or facilities.

Further, production of reserves from reservoirs in the Gulf of Mexico generally decline more rapidly than from fields in many other producing regions of the world. This results in recovery of a relatively higher percentage of reserves from properties in the Gulf of Mexico during the initial years of production, and as a result, our reserve replacement needs from new prospects may be greater there than for our operations elsewhere. Also, our revenues and return on capital will depend significantly on prices prevailing during these relatively short production periods.

Hedging transactions may limit our potential gains.

We have entered into natural gas price hedging arrangements with respect to a significant portion of our expected production through 2009. Such transactions may limit our potential gains if oil and natural gas prices were to rise substantially over the price established by the hedge. In addition, such transactions may expose us to the risk of loss in certain circumstances, including instances in which our production is less than expected, there is a widening of price differentials between delivery points for our production and the delivery point assumed in the hedge arrangement, or the counterparties to our hedging agreements fail to perform under the contracts.

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The historical financial results of the domestic oil and natural gas business of Calpine may not be representative of our results as a separate company.

The combined historical financial information included in this report does not necessarily reflect what our financial position, results of operations and cash flows would have been had we been a separate, stand-alone entity during the periods presented. The costs and expenses reflect charges from Calpine for centralized corporate services and infrastructure costs. The allocations were determined based on Calpine’s methodologies. This combined historical financial information is not necessarily indicative of what our results of operations, financial position and cash flows will be in the future.

Failure to achieve and maintain effective internal control over financial reporting in accordance with the rules of the SEC could harm our business.

Under current rules of the SEC, as of December 31, 2007, we will be required to document and test our internal control over financial reporting so that our management can certify as to the effectiveness of our internal control over financial reporting and our independent registered public accounting firm can render an opinion on management’s assessment. We cannot be certain as to the timing of completion of our evaluation, testing and remediation actions, if any, or the impact of the same on our operations. The assessment of our internal control over financial reporting will require us to expend significant management and employee time and resources and incur significant additional expense.

We have begun the process of evaluating and documenting our internal control over financial reporting in order to test and determine whether any remediation actions may be necessary to fully implement the requirements relating to internal controls and all other aspects of related SEC rules and the Sarbanes Oxley Act of 2002. Management believes it has remediated the material weaknesses noted as of December 31, 2005: (1) lack of a sufficient complement of permanent personnel to have an appropriate accounting and financial reporting structure to support the activities of the Company and (2) ineffective controls as related to the identification and documentation of accounting policies, including selection and application of generally accepted accounting principles used for accounting for select transactions and other activities; however, see Item 9A. Controls and Procedures, for a further discussion on these material weaknesses.

Although we expect to fully implement the requirements to meet the required SEC and Sarbanes-Oxley standards in 2007, our efforts may not be successful and additional deficiencies or weaknesses in our internal controls and procedures may be identified.

Our prior and continuing relationship with Calpine exposes us to risks attributable to Calpine’s businesses and credit worthiness.

We acquired a business that previously was integrated within Calpine and is subject to liabilities and risk for activities of businesses of Calpine other than the acquired business. In connection with our separation from Calpine, Calpine and certain of its subsidiaries have agreed to retain and indemnify us for certain liabilities. Third parties may seek to hold us responsible for some or all of those retained liabilities.

Any claims made against us that are properly attributable to Calpine and certain of its subsidiaries will require us to exercise our rights under the indemnification provisions of the purchase and sale agreement to obtain payment from them. We are exposed to the risk that, in these circumstances and in light of the Calpine bankruptcy, any or all of Calpine and certain of its subsidiaries cannot or will not make the required payment. If this were to occur, our business and results of operations, financial position or cash flow could be adversely affected.

If we are unable to obtain governmental approvals arising from the Acquisition, we may not acquire all of Calpine's domestic oil and gas business.

The consummation of the Acquisition required various approvals, filings and recordings with governmental entities to transfer existing contracts and arrangements as well as all of Calpine's domestic oil and gas properties to us. In addition, all government issued permits and licenses that are important to our business, including permits issued by the City of Rio Vista and Counties of Sacramento, Solano and Contra Costa, California, may require reapplication or application by us and reissuance or issuance in our name. Some of the required permits, licenses and approvals have been obtained or received, but certain others remain outstanding. If we are unable to obtain a reissuance or issuance of any contract, license or permit being transferred or the required approvals as operator and/or lessee, as to certain oil and gas properties, our business and results of operations, financial position and cash flow could be adversely affected.

The SEC informal inquiry relating to the downward revision of the estimate of continuing proved reserves, while owned by Calpine, could have a material adverse effect on the presentation of our predecessor financial statements.

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In April 2005, the staff of the Division of Enforcement of the SEC commenced an informal inquiry into the facts and circumstances relating to the downward revision of the estimate of continuing proved natural gas reserves at December 31, 2004, while the domestic oil and natural gas properties were owned by Calpine. Calpine has advised us that it is fully cooperating with this informal inquiry which also involved two other non-oil and natural gas related matters, and we have separately agreed with Calpine that we will also fully cooperate. Calpine has advised us that it has not had any further response or inquiry from the SEC staff in regard to this matter since July 2005 and that the ultimate outcome of this inquiry cannot presently be determined. However, it is possible that the staff of the SEC could conclude that the estimate of continuing proved reserves as of December 31, 2004, as revised, requires further downward revision, which could have a material adverse effect on the presentation of our predecessor financial statements.

Future sales of our common stock may cause our stock price to decline.

Sales of substantial amounts of our common stock in the public market, or the perception that these sales may occur, could cause the market price of our common stock to decline, which could impair our ability to raise capital through the sale of additional common or preferred stock.

Stock sales and purchases by institutional investors or stockholders with significant holdings could have significant influence over our stock volatility and our corresponding ability to raise capital through debt or equity offerings.

Because institutional investors have the ability to trade in large volumes of shares of our common stock, the price of our common stock could be subject to significant volatility, which could adversely affect the market price for our common stock as well as limit our ability to raise capital or issue additional equity in the future.

You may experience dilution of your ownership interests because of the future issuance of additional shares of our common and preferred stock.

We may in the future issue our previously authorized and unissued equity securities, resulting in the dilution of the ownership interests of our present stockholders and purchasers of common stock offered hereby. We are currently authorized to issue an aggregate of 155,000,000 shares of capital stock consisting of 150,000,000 shares of common stock and 5,000,000 shares of preferred stock with preferences and rights as determined by our Board of Directors. As of December 31, 2006, 50,732,694 shares of common stock were issued, including 673,875 shares of restricted stock issued to certain employees and directors. The majority of these vest over a three year period. Of the restricted stock that has been granted, 346,975 shares had vested as of December 31, 2006 and the remaining shares will vest on a three year period ending in 2009. Pursuant to our 2005 Long-Term Incentive Plan, we have reserved 3,000,000 shares of our common stock for issuance as restricted stock, stock options and/or other equity based grants to employees and directors. Of the reserved shares, 1,233,333 may be awarded as restricted stock and 1,766,667 may be awarded as stock options and/or other equity based grants and includes 903,250 options to purchase common stock issued to certain employees and directors, of which 50,396 have been exercised as of December 31, 2006. The potential issuance of such additional shares of common stock may create downward pressure on the trading price of our common stock. We may also issue additional shares of our common stock or other securities that are convertible into or exercisable for common stock in connection with the hiring of personnel, future acquisitions, future issuance of our securities for capital raising purposes, or for other business purposes.

Provisions under Delaware law, our certificate of incorporation and bylaws could delay or prevent a change in control of our company, which could adversely affect the price of our common stock.

The existence of some provisions under Delaware law, our certificate of incorporation and bylaws could delay or prevent a change in control of the Company, which could adversely affect the price of our common stock. Delaware law imposes restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. Our certificate of incorporation and bylaws prohibit our stockholders from taking action by written consent absent approval by all members of our Board of Directors. Further, our stockholders do not have the power to call a special meeting of stockholders.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

A description of our properties is located in Item 1. Business and is incorporated herein by reference.

Our headquarters are located at 717 Texas, Suite 2800, Houston, Texas 77002, where we sublease two floors of office space from Calpine. We also maintain a division office in Denver, Colorado, where we were assigned a lease by Calpine and consequently deal directly with the landlord. We also have field offices in Laredo, Texas and Rio Vista, California. All leases were negotiated at market prices applicable to their respective location.

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Title to Properties

Our properties are subject to customary royalty interests, liens incident to operating agreements, liens for current taxes and other burdens, including other mineral encumbrances and restrictions as well as mortgage liens on at least 80% of our proved reserves in accordance with our credit facilities. We do not believe that any of these burdens materially interferes with our use of the properties in the operation of our business.

Except as noted in the "Transfers of Legal Title Pending at Calpine's Bankruptcy" section in Item 3. Legal Proceedings, we believe that we have generally satisfactory title to or rights in all of our producing properties. As is customary in the oil and natural gas industry, we make minimal investigation of title at the time we acquire undeveloped properties. We make title investigations and receive title opinions of local counsel only before we commence drilling operations. We believe that we have satisfactory title to all of our other assets. Although title to our properties is subject to encumbrances in certain cases, we believe that none of these burdens will materially detract from the value of our properties or from our interest therein or will materially interfere with our use in the operation of our business.

Calpine's recent bankruptcy may delay or frustrate our ability to complete additional transfers of properties for which legal title were not obtained as of July 7, 2005.

Item 3. Legal Proceedings

We are party to various oil and natural gas litigation matters arising out of the ordinary course of business. While the outcome of these proceedings cannot be predicted with certainty, we do not expect these matters to have a material adverse effect on the financial statements.

We carry insurance with coverage and coverage limits consistent with our assessment of risks in our business and of an acceptable level of financial exposure. Although there can be no assurance that such insurance will be sufficient to mitigate all damages, claims or contingencies, we believe that our insurance provides reasonable coverage for known asserted or unasserted claims. In the event we sustain a loss from a claim and the insurance carrier disputed coverage or coverage limits, we may record a charge in a different period than the recovery, if any, from the insurance carrier.

Calpine Bankruptcy

Calpine Corporation and certain of its subsidiaries filed for protection under the federal bankruptcy laws in the Bankruptcy Court on December 20, 2005. Calpine Energy Services, L.P., which filed for bankruptcy, has continued to make the required deposits into the Company's margin account and to timely pay for natural gas production it purchases from the Company's subsidiaries under various natural gas supply agreements. As part of the Acquisition, Calpine and the Company entered into a Transition Services Agreement, pursuant to which both parties were to provide certain services for the other for various periods of time. Calpine's obligation to provide services under the Transition Services Agreement ceased on July 6, 2006 and certain of Calpine's services ceased prior to the conclusion of the contract, which in neither case had any material effect on the Company. Additionally, Calpine Producer Services, L.P., which filed for bankruptcy, generally is performing its obligations under the Marketing and Services Agreement ("MSA") with the Company. The MSA was entered into by the Company and Calpine in July 2005 for the period through June 30, 2007.

The filing raises certain concerns regarding aspects of our relationship with Calpine which we will closely monitor as the Calpine bankruptcy proceeds. See further discussion of our concerns under Item 1A. Risk Factors.

Transfers of Legal Title Pending at Calpine's Bankruptcy

At the closing of the Acquisition on July 7, 2005, we retained approximately $75 million of the purchase price in respect to Non-Consent Properties identified by Calpine at the time of the Acquisition as requiring third party consents or waivers of preferential rights to purchase that were not received before closing. Legal title for those Non-Consent Properties was not delivered at the closing. Subsequent analysis determined that a portion of the Non-Consent Properties, with an approximate allocation value of $29 million under the Purchase Agreement did not require consents or waivers. For that portion of the Non-Consent Properties for which third party consents were in fact required (having an approximate value of $39 million under the Purchase Agreement) and for which we obtained the required consents or waivers, as well as for all Non-Consent Properties that did not require consents or waivers, we believe that Calpine was and is obligated to have transferred to us the record legal title, free of any mortgages and other liens.

The approximate allocated value under the Purchase Agreement for the portion of the Non-Consent Properties subject to a third party's preferential right to purchase is $7.4 million. We have retained $7.1 million of the purchase price under the Purchase Agreement for the Non-Consent Properties subject to a third party's preferential right to purchase, and, in addition, a post-closing adjustment is required to credit us for approximately $0.3 million for a property which was transferred to us but will be transferred to the appropriate third party should it properly exercise its preferential purchase right and upon Calpine's performance of its remaining obligations under the Purchase Agreement.

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We believe all conditions precedent for our receipt of record title, free of any mortgages or other liens, for substantially all of the Non-Consent Properties (excluding that portion of these properties for which a third party's preferential right to purchase was properly exercised) were satisfied earlier, and certainly no later than December 15, 2005, when we tendered once again the amounts necessary to conclude the settlement of the Non-Consent Properties.

We believe we are the equitable owner of each of the Non-Consent Properties for which Calpine was and is obligated to have transferred to us the record legal title and that such properties are not part of Calpine's bankruptcy estate. Upon our receipt from Calpine of record legal title, free of any mortgages or other liens, to these Non-Consent Properties and Calpine's performance or its further assurances required to eliminate any open issues on title to the remaining properties discussed below, we are prepared to pay Calpine approximately $68 million, subject to appropriate adjustment for the associated net revenues and expenses through December 15, 2005 and performance of Calpine's obligations under the "further assurances" provisions of the Purchase and Sale Agreement. Our statement of operations for the year ended December 31, 2006 and six months ended December 31, 2005 does not include any net revenues or production from any of the Non-Consent Properties, or those properties subject to preferential rights.

If Calpine does not provide us with record legal title, free of any mortgages for all of these properties and other liens, to any of the Non-Consent Properties (excluding that portion of these properties subject to a validly exercised third party's preferential right to purchase), we will have a total of approximately $68 million available to us for general corporate purposes, including for the purpose of acquiring additional properties. We also have approximately $7.1 million, previously withheld for that portion of the Non-Consent Properties subject to a third party's preferential right to purchase, which will also be available to us for general corporate purposes, including for the purpose of acquiring additional properties should that third party properly exercise their preferential rights.

In addition, as to certain of the other oil and natural gas properties we purchased from Calpine in the Acquisition and for which payment was made on July 7, 2005, we will seek additional documentation from Calpine to eliminate any open issues in our title or resolve any issues as to the clarity of our ownership. Requests for additional documentation are customary in connection with transactions similar to the Acquisition. In the Acquisition, certain of these properties require ministerial governmental action approving us as qualified assignee and operator, which is typically required even though in most cases Calpine has already conveyed the properties to us free and clear of mortgages and liens by Calpine's creditors. As to certain other properties, the documentation delivered by Calpine at closing under the Purchase Agreement was incomplete. We remain hopeful that Calpine will work cooperatively with us to secure these ministerial governmental approvals and to accomplish the curative corrections for all of these properties. In addition, as to all properties acquired by us in the Acquisition, Calpine contractually agreed to provide us with such further assurances as we may reasonably request. Nevertheless, as a result of Calpine's bankruptcy filing, it remains uncertain as to whether Calpine will respond cooperatively. If Calpine does not fulfill its contractual obligations and does not complete the documentation necessary to resolve these issues, we will pursue all available remedies, including but not limited to a declaratory judgment to enforce our rights and actions to quiet title. After pursuing these matters, if we experience a loss of ownership with respect to these properties without receiving adequate consideration for any resulting loss to us, an outcome our management considers to be remote, then we could experience losses which could have a material adverse effect on our financial condition, statement of operations and cash flows.

On June 29, 2006, Calpine filed a motion in connection with its pending bankruptcy proceeding in the Bankruptcy Court seeking the entry of an order authorizing Calpine to assume certain oil and natural gas leases Calpine has previously sold or agreed to sell to us in the Acquisition, to the extent those leases constitute "unexpired leases of non-residential real property" and were not fully transferred to us at the time of Calpine's filing for bankruptcy. According to this motion, Calpine filed it in order to avoid the automatic forfeiture of any interest it may have in these leases by operation of a statutory deadline. Calpine's motion did not request that the Bankruptcy Court determine whether these properties belong to us or Calpine, but we understand it was meant to allow Calpine to preserve and avoid forfeiture under the Bankruptcy Code of whatever interest Calpine may possess, if any, in these oil and natural gas leases. We dispute Calpine's contention that it may have an interest in any significant portion of these oil and natural gas leases and intend to take the necessary steps to protect all of our rights and interest in and to the leases. On July 7, 2006, we filed an objection in response to Calpine's motion, wherein we asserted that oil and natural gas leases constitute interests in real property that are not subject to "assumption" under the Bankruptcy Code. In the objection we also requested that (a) the Bankruptcy Court eliminate from the order certain Federal offshore leases from the Calpine motion because these properties were fully conveyed to us in July 2005, and the Minerals Management Service has subsequently recognized us as owner and operator of all but three of these properties, and (b) any order entered by the Bankruptcy Court be without prejudice to, and fully preserve our rights, claims and legal arguments regarding the characterization and ultimate disposition of the remaining described oil and natural gas properties. In our objection, we also urged the Bankruptcy Court to require the parties to promptly address and resolve any remaining issues under the pre-bankruptcy definitive agreements with Calpine and proposed to the Bankruptcy Court that the parties seek arbitration (or at least mediation) to complete the following:

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- Calpine's conveyance of the Non-Consent Properties to us;

- Calpine's execution of all documents and performance of all tasks required under "further assurances" provisions of the Purchase Agreement with respect to certain of the oil and natural gas properties for which we have already paid Calpine; and

- Resolution of the final amounts we are to pay Calpine, which we have concluded are approximately $79 million, consisting of roughly $68 million for the Non-Consent Properties and approximately $11 million in other true-up payment obligations.

At a hearing held on July 12, 2006, the Bankruptcy Court took the following steps:

- In response to an objection filed by the Department of Justice and asserted by the California State Lands Commission that the Debtors' Motion to Assume Non-Residential Leases and Set Cure Amounts (the "Motion"), did not allow adequate time for an appropriate response, Calpine withdrew from the list of Oil and Gas Leases that were the subject of the Motion those leases issued by the United States (and managed by the Minerals Management Service of the United States Department of Interior) (the "MMS Oil and Gas Leases") and the State of California (and managed by the California State Lands Commission) (the "CSLC Leases"). Calpine and both the Department of Justice and the State of California agreed to an extension of the existing deadline to November 15, 2006 to assume or reject the MMS Oil and Gas Leases and CSLC Leases under Section 365 of the Bankruptcy Code, to the extent the MMS Oil and Gas Leases and CSLC Leases are leases subject to Section 365. The effect of these actions was to render our objection inapplicable at that time; and

- The Bankruptcy Court also encouraged Calpine and us to arrive at a business solution to all remaining issues including approximately $68 million payable to Calpine for conveyance of the Non-Consent Properties.

On August 1, 2006, we filed a number of proofs of claim in the Calpine bankruptcy asserting claims against a variety of Calpine debtors seeking recovery of $27.9 million in liquidated amounts as well as unliquidated damages in amounts that can not presently be determined. We continue to work with Calpine on a cooperative and expedited basis toward resolution of unresolved conveyance of properties and post-closing adjustments under the Purchase Agreement.

With respect to the stipulations between Calpine and MMS and Calpine and CSLC extending the deadline to assume or reject the MMS Oil and Gas Leases, these parties have further extended this deadline time by stipulation. The deadline was first extended to January 31, 2007 and recently was further extended to April 15, 2007 with respect to the MMS Oil and Gas Leases and April 30, 2007 with respect to the CSLC Leases. The Bankruptcy Court entered Orders related to the MMS Oil and Gas Leases and CSLC Leases which included appropriate language that we negotiated with Calpine for our protection in this regard.

Recently, Calpine sought and obtained an extension to June 20, 2007 from the Bankruptcy Court for the period in which only Calpine, exclusively, may file its plan of reorganization. While there is no assurance that Calpine will file a plan of reorganization by the deadline, or that such a plan will be approved by the creditors and the Bankruptcy Court, we remain optimistic that the issues involving conclusion of the remaining conveyances of the Non-Consent Properties and obtaining the further assurances from Calpine under the Purchase Agreement, including perhaps resolution of any and all claims, may occur during 2007.

Calpine recently requested Bankruptcy Court approval of a new credit facility which would require it to grant liens to these new lenders in all of its assets, including any interest it may still hold in any oil and gas properties it obligated itself to convey to us under the Purchase Agreement. The Bankruptcy Court entered into an Order approving Calpine's ability to obtain this new loan which includes appropriate language that we negotiated with Calpine for our protection in this regard.

However, there can be no assurance that Calpine, its creditors or other interest holders will not challenge the fairness of the Acquisition. For a number of reasons, including our understanding of the process that Calpine followed in allowing market forces to set the purchase price for the Acquisition, we continue to believe that it is unlikely that any challenges by the Calpine debtors or their creditors to the overall fairness of the Acquisition would be successful. We will take all necessary action to ensure our rights under the Purchase Agreement, the MMS Oil and Gas Leases, the CSLC Leases and the Bankruptcy Code are fully protected.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of our security holders during the fourth quarter of 2006.

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Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Trading Market

Our common stock is listed on The NASDAQ Global Select Market® under the symbol "ROSE". Our common stock began publicly trading on February 13, 2006. Prior to such date, there was no public market for our common stock. However, certain qualified institutional investors participated in limited trading through quotes on The PORTAL Market after July 7, 2005.

The following table sets forth for the 2006 periods indicated the high and low sale prices of our common stock:

	High	Low
February 13 - March 31	$ 18.75	$ 17.67
April 1 - June 30	21.48	15.81
July 1 - September 30	19.05	15.82
October 1 - December 31	19.89	16.71

The number of shareholders on March 5, 2007 was 13,444. However, we estimate that we have a significantly greater number of beneficial shareholders because a substantial number of our common shares are held of record by brokers or dealers for the benefit of their customers.

We have not paid a cash dividend on our common stock and currently intend to retain earnings to fund the growth and development of our business. Any future change in our policy will be made at the discretion of our board of directors in light of the financial condition, capital requirements, earnings prospects of Rosetta and any limitations imposed by lenders or investors, as well as other factors the board of directors may deem relevant.

The following table sets forth certain information with respect to repurchases of our common stock during the three months ended December 31, 2006:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May yet Be Purchased Under the Plans or Programs
October 1 - October 31	945	$ 17.93	-	-
November 1 - November 30	962	19.15	-	-
December 1 - December 31	-	-	-	-

(1)

All of the shares were surrendered by the employees to pay tax withholding upon the vesting of restricted stock awards. These repurchases were not part of a publicly announced program to repurchase shares of our common stock, nor do we have a publicly announced program to repurchase shares of common stock.

Stock Performance Graph

The following graph compares our common stock performance (“ROSE”) with the performance of the Standard & Poors’ 500 Stock Index (“S&P 500 Index”) and the performance of our peers within the oil and gas industry. The seven companies that comprise our peer group are Petrohawk Energy Corporation (HAWK), St. Mary Land & Exploration Co. (SM), Bill Barrett Corp. (BBG), Brigham Exploration Co. (BEXP), Berry Petroleum Co. (BRY), Comstock Resources Inc. (CRK) and Range Resources Corp. (RRC), (“Peer Group”). The graph assumes the value of the investment in our common stock , the S&P 500 Index, and our Peer Group was $100 on February 13, 2006 and that all dividends are reinvested.

The performance graph shall not be deemed incorporated by reference by any general statement incorporating by reference this Annual Report into any filing under the Securities Act of 1933, except to the extent we specifically incorporate this information by reference and shall not otherwise be deemed filed under such acts.

Total Return Among Rosetta Resources, Inc., the S&P 500 Index and our Peer Group

		2/13/2006 (1)		**12/31/2006**
ROSE	$	100.00	$	98.26
S&P 500 Index	$	100.00	$	111.94
Peer Group	$	100.00	$	94.82

(1) February 13, 2006 was the first full trading day following the effective date of the Company’s registration statement filed in connection with the public offering of its common stock.

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Item 6. Selected Financial Data

The following table sets forth our selected financial data. For the year ended December 31, 2006 (Successor) and the six months ended December 31, 2005 (Successor), the financial data has been derived from the consolidated financial statements of Rosetta Resources Inc. For the six months ended June 30, 2005 (Predecessor) and for the years ended December 31, 2004, 2003 and 2002 (Predecessor), the financial data was derived from the combined financial statements of the domestic oil and natural gas properties of Calpine and are presented on a carve-out basis to include the historical operations of the domestic oil and natural gas business. You should read the following selected historical consolidated/combined financial data in connection with "Management's Discussion and Analysis of Financial Condition and Results of Operation" and the audited Consolidated/Combined Financial Statements and related notes included elsewhere in this report.

Additionally, the historical financial data reflects successful efforts accounting for oil and natural gas properties for the Predecessor periods described above and the full cost method of accounting for oil and natural gas properties effective July 1, 2005 for the Successor periods. In addition, Calpine adopted on January 1, 2003, SFAS No. 123, "Accounting for Stock-Based Compensation", as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure" (SFAS No. 123") to measure the cost of employee services received in exchange for an award of equity instruments, whereas we adopted the intrinsic value method of accounting for stock options and stock awards pursuant to Accounting Principles Board Opinion No. 25, "Stock Issued to Employees" ("APB No. 25") effective July 2005, and as required have adopted the guidance for stock-based compensation under SFAS No. 123 (revised 2004) "Share-Based Payments" ("SFAS No. 123R") effective January 1, 2006.

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	Successor-Consolidated		Predecessor - Combined			
	Year Ended December 31, 2006	Six Months Ended December 31, 2005	Six Months Ended June 30, 2005	Year Ended December 31, 2004	2003	2002
	(In thousands, except per share data)					
Operating Data:						
Total revenue	$ 271,763	$ 113,104	$ 103,831	$ 248,006	$ 279,916	$ 157,372
Income (loss) from continuing operations (1)	44,608	17,535	18,681	(78,836)	66,879	1,484
Net income (loss)	44,608	17,535	18,681	(10,396)	71,440	(168)
Income per share:						
Income (loss) from continuing operations						
Basic	0.89	0.35	0.37	(1.58)	1.34	0.03
Diluted	0.88	0.35	0.37	(1.58)	1.33	0.03
Net income (loss)						
Basic	0.89	0.35	0.37	(0.21)	1.43	-
Diluted	0.88	0.35	0.37	(0.21)	1.42	-
Cash dividends declared per common share	-	-	-	-	-	-
Balance Sheet Data (At the end of the Period)						
Total assets	1,219,405	1,119,269	-	656,528	990,893	940,619
Long-term debt	240,000	240,000	-	-	507	684
Stockholders' equity/owner's net investment	822,289	715,423	-	223,451	233,847	162,407

(1) Includes a $202.1 million impairment charge for the year ended December 31, 2004.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are an independent oil and natural gas company engaged in the acquisition, exploration, development and production of natural gas and oil properties in the United States. We were formed as a Delaware corporation in June 2005. In July 2005, we acquired the oil and natural gas business of Calpine Corporation and affiliates. We own producing and non-producing oil and natural gas properties in the Sacramento Basin of California, the Lobo and Perdido Trends in South Texas, the State Waters of Texas, the Gulf of Mexico, the Rocky Mountains and other properties located in various geographical areas in the United States. In this section, we refer to Rosetta as “Successor” and to the domestic oil and natural gas properties acquired from Calpine as “Predecessor”.

In accounting for the oil and natural gas exploration and production business, the Predecessor used the successful efforts method of accounting for oil and natural gas activities. However, in connection with our separation from

Calpine, we have adopted the full cost method of accounting for our oil and natural gas properties, (see "Critical Accounting Policies and Estimates—Oil and Gas Activities" below for further discussion of the differences on the Consolidated/Combined Financial Statements of the two accounting methods).

We plan our activities and budget based on conservative sales price assumptions given the inherent volatility of oil and natural gas prices that are influenced by many factors beyond our control. We focus our efforts on increasing oil and natural gas reserves and production while controlling costs at a level that is appropriate for long-term operations. Our future earnings and cash flows are dependent on our ability to manage our overall cost structure to a level that allows for profitable production. Our future earnings will also be impacted by the changes in the fair market value of hedges we executed to mitigate the volatility in the changes of oil and natural gas prices in future periods. These instruments meet the criteria to be accounted for as cash flow hedges, and until settlement, the changes in fair market value of our hedges will be included as a component of stockholder's equity to the extent effective. In periods of rising prices, these transactions will mitigate future earnings and in periods of declining prices will increase future earnings in the respective period the positions are settled.

Like all oil and natural gas exploration and production companies, we face the challenge of natural production declines. As initial reservoir pressures are depleted, oil and natural gas production from a given well naturally decreases. Thus, an oil and natural gas exploration and production company depletes part of its asset base with each unit of oil or natural gas it produces. We attempt to overcome this natural decline by drilling and acquiring more reserves than we produce. Our future growth will depend on our ability to continue to add reserves in excess of production. We will maintain our focus to add reserves through drilling and acquisitions as well as the costs necessary to produce our reserves. Our ability to add reserves through drilling is dependent on our capital resources and can be limited by many factors, including our