

COMSTOCK RESOURCES INC

Form 10-Q

November 04, 2010

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the Quarter Ended September 30, 2010

OR

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

Commission File No. 001-03262

COMSTOCK RESOURCES, INC.

(Exact name of registrant as specified in its charter)

NEVADA

(State or other jurisdiction of
incorporation or organization)

94-1667468

(I.R.S. Employer
Identification Number)

5300 Town and Country Blvd., Suite 500, Frisco, Texas 75034

(Address of principal executive offices)

Telephone No.: **(972) 668-8800**

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of the registrant's common stock, par value \$.50, as of November 4, 2010 was 47,317,356.

COMSTOCK RESOURCES, INC.
QUARTERLY REPORT
For the Quarter Ended September 30, 2010
INDEX

	Page
<u>PART I. Financial Information</u>	
<u>Item 1. Financial Statements (Unaudited):</u>	
<u>Consolidated Balance Sheets - September 30, 2010 and December 31, 2009</u>	4
<u>Consolidated Statements of Operations - Three Months and Nine Months ended September 30, 2010 and 2009</u>	5
<u>Consolidated Statement of Stockholders' Equity and Comprehensive Loss - Nine Months ended September 30, 2010</u>	6
<u>Consolidated Statements of Cash Flows - Nine Months ended September 30, 2010 and 2009</u>	7
<u>Notes to Consolidated Financial Statements</u>	8
<u>Report of Independent Registered Public Accounting Firm</u>	16
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 3. Quantitative and Qualitative Disclosure About Market Risk</u>	21
<u>Item 4. Controls and Procedures</u>	21
<u>PART II. Other Information</u>	
<u>Item 6. Exhibits</u>	23
<u>EX-15.1</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	
<u>EX-101 DEFINITION LINKBASE DOCUMENT</u>	

Table of Contents

PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

3

Table of Contents

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2010	December 31, 2009
	<i>(In thousands)</i>	
ASSETS		
Cash and Cash Equivalents	\$ 4,350	\$ 90,472
Accounts Receivable:		
Oil and gas sales	25,013	31,435
Joint interest operations	7,171	8,845
Marketable Securities	70,661	95,973
Income Taxes Receivable		42,402
Other Current Assets	3,577	4,259
Total current assets	110,772	273,386
Property and Equipment:		
Unevaluated oil and gas properties	226,954	130,364
Oil and gas properties, successful efforts method	2,586,057	2,289,571
Other property and equipment	18,229	6,477
Accumulated depreciation, depletion and amortization	(1,013,278)	(850,125)
Net property and equipment	1,817,962	1,576,287
Other Assets	7,856	9,288
	\$ 1,936,590	\$ 1,858,961
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts Payable	\$ 76,479	\$ 67,488
Accrued Expenses	27,729	20,695
Deferred Income Taxes Payable	369	6,588
Total current liabilities	104,577	94,771
Long-term Debt	528,238	470,836
Deferred Income Taxes Payable	224,686	220,682
Reserve for Future Abandonment Costs	6,975	6,561
Other Non-current Liabilities	2,600	
Total liabilities	867,076	792,850
Commitments and Contingencies		
Stockholders Equity:		
Common stock \$0.50 par, 75,000,000 shares authorized, 47,317,356 and 47,103,770 shares outstanding at September 30, 2010 and December 31, 2009, respectively	23,659	23,552

Edgar Filing: COMSTOCK RESOURCES INC - Form 10-Q

Additional paid-in capital	450,124	434,505
Retained earnings	578,458	577,435
Accumulated other comprehensive income	17,273	30,619
Total stockholders' equity	1,069,514	1,066,111
	\$ 1,936,590	\$ 1,858,961

The accompanying notes are an integral part of these statements.

4

Table of Contents

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended		Nine Months Ended September	
	September 30,		30,	
	2010	2009	2010	2009
	<i>(In thousands, except per share amounts)</i>			
Revenues:				
Oil and gas sales	\$ 79,720	\$ 67,436	\$ 276,491	\$ 200,662
Operating expenses:				
Production taxes	3,062	1,848	9,543	5,486
Gathering and transportation	4,101	1,368	12,308	3,962
Lease operating	13,002	12,803	41,150	41,015
Exploration	1,238	227	2,506	371
Depreciation, depletion and amortization	46,796	53,933	163,603	152,001
Impairment of oil and gas properties	26	115	213	115
General and administrative, net	9,400	8,689	28,965	27,559
Total operating expenses	77,625	78,983	258,288	230,509
Operating income (loss)	2,095	(11,547)	18,203	(29,847)
Other income (expenses):				
Interest income	5	3	263	35
Other income	100	23	145	115
Gain on sale of assets			4,895	
Interest expense	(7,108)	(3,244)	(22,551)	(8,307)
Total other income (expenses)	(7,003)	(3,218)	(17,248)	(8,157)
Income (loss) before income taxes	(4,908)	(14,765)	955	(38,004)
Benefit from income taxes	208	2,193	68	8,300
Net income (loss)	\$ (4,700)	\$ (12,572)	\$ 1,023	\$ (29,704)
Net income (loss) per share:				
Basic	\$ (0.10)	\$ (0.28)	\$ 0.02	\$ (0.66)
Diluted	\$ (0.10)	\$ (0.28)	\$ 0.02	\$ (0.66)
Weighted average shares outstanding:				
Basic	45,623	45,032	45,537	44,992
Diluted	45,623	45,032	45,589	44,992

The accompanying notes are an integral part of these statements.

Table of Contents

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
AND COMPREHENSIVE LOSS
For the Nine Months Ended September 30, 2010
(Unaudited)

	Common Stock	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(Shares)					
			<i>(In thousands)</i>			
Balance at January 1, 2010	47,104	\$ 23,552	\$ 434,505	\$ 577,435	\$ 30,619	\$ 1,066,111
Exercise of stock options	177	89	1,204			1,293
Stock-based compensation	36	18	12,912			12,930
Tax benefit from stock-based compensation			1,503			1,503
Net income				1,023		1,023
Net change in unrealized gains and losses on marketable securities, net of income taxes					(13,346)	(13,346)
Total comprehensive loss						(12,323)
Balance at September 30, 2010	47,317	\$ 23,659	\$ 450,124	\$ 578,458	\$ 17,273	\$ 1,069,514

The accompanying notes are an integral part of these statements.

Table of Contents

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended	
	September 30,	
	2010	2009
	<i>(In thousands)</i>	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 1,023	\$ (29,704)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Deferred income taxes	131	22,318
Depreciation, depletion and amortization	163,603	152,001
Impairment of oil and gas properties	213	115
Gain on sale of assets	(4,895)	
Debt issuance costs and discount amortization	1,834	608
Stock-based compensation	12,930	11,533
Excess tax benefit from stock-based compensation	(1,503)	(974)
Decrease in accounts receivable	8,096	12,043
(Increase) decrease in other current assets	49,428	(23,378)
Increase (decrease) in accounts payable and accrued expenses	18,376	(26,712)
Net cash provided by operating activities	249,236	117,850
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(406,778)	(253,475)
Proceeds from sales of assets	11,624	
Net cash used for investing activities	(395,154)	(253,475)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings	60,000	130,000
Principal payments on debt	(3,000)	
Proceeds from issuance of common stock	1,293	1,470
Excess tax benefit from stock-based compensation	1,503	974
Debt issuance costs		(6)
Net cash provided by financing activities	59,796	132,438
Net decrease in cash and cash equivalents	(86,122)	(3,187)
Cash and cash equivalents, beginning of period	90,472	6,281
Cash and cash equivalents, end of period	\$ 4,350	\$ 3,094

The accompanying notes are an integral part of these statements.

7

Table of Contents

**COMSTOCK RESOURCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 30, 2010

(Unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

In management's opinion, the accompanying unaudited consolidated financial statements contain all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the financial position of Comstock Resources, Inc. and subsidiaries (Comstock or the Company) as of September 30, 2010 and the related results of operations for the three and nine months ended September 30, 2010 and 2009, and cash flows for the nine months ended September 30, 2010 and 2009.

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted pursuant to those rules and regulations, although Comstock believes that the disclosures made are adequate to make the information presented not misleading. These unaudited consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in Comstock's Annual Report on Form 10-K for the year ended December 31, 2009.

The results of operations for the three months and nine months ended September 30, 2010 are not necessarily an indication of the results expected for the full year.

These unaudited consolidated financial statements include the accounts of Comstock and its wholly owned and controlled subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

Reclassifications

Certain reclassifications have been made to prior periods' financial statements to conform to the current presentation.

Marketable Securities

As of September 30, 2010 the Company owned 4,797,069 shares of Stone Energy Corporation common stock. The Company does not exert influence over the operating and financial policies of Stone Energy Corporation, and has classified its investment in these shares as an available-for-sale security in the consolidated balance sheets. Available-for-sale securities are accounted for at fair value, with any unrealized gains and unrealized losses not determined to be other than temporary reported in the consolidated balance sheet within accumulated other comprehensive income as a separate component of stockholders' equity. The Company utilizes the specific identification method to determine the cost of any securities sold. In April 2010 the Company sold 520,000 shares of Stone Energy Corporation and received proceeds of \$10.5 million. Comstock realized a gain before income taxes on this sale of \$5.7 million which is included in other income (expense) in the consolidated statements of operations.

Table of Contents

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

The Company reviews its available-for-sale securities to determine whether a decline in fair value below the respective cost basis is other than temporary. If the decline in fair value is judged to be other than temporary, the cost basis of the security is written down to fair value and the amount of the write-down is included in the consolidated statement of operations. As of September 30, 2010, the estimated fair value of the Stone Energy Corporation shares, based on the market price for the shares, was \$70.7 million after recognizing an unrealized gain after income taxes of \$17.3 million.

Reserve for Future Abandonment Costs

Comstock's asset retirement obligations relate to future plugging and abandonment expenses on its oil and gas properties and related facilities disposal. The following table summarizes the changes in Comstock's total estimated liability during the nine months ended September 30, 2010 and 2009:

	Nine Months Ended	
	September 30,	
	2010	2009
	<i>(In thousands)</i>	
Beginning future abandonment costs	\$ 6,561	\$ 5,480
Accretion expense	290	233
New wells placed on production and changes in estimates	190	342
Liabilities settled	(66)	(25)
Future abandonment costs – end of period	\$ 6,975	\$ 6,030

Revenue Recognition and Gas Balancing

Comstock utilizes the sales method of accounting for oil and natural gas revenues whereby revenues are recognized at the time of delivery based on the amount of oil or natural gas sold to purchasers. Revenue is typically recorded in the month of production based on an estimate of the Company's share of volumes produced and prices realized. Revisions to such estimates are recorded as actual results are known. The amount of oil or natural gas sold may differ from the amount to which the Company is entitled based on its revenue interests in the properties. The Company did not have any significant imbalance positions at September 30, 2010 or December 31, 2009.

Derivative Financial Instruments

Comstock periodically uses swaps, floors and collars to hedge oil and natural gas prices and interest rates. Swaps are settled monthly based on differences between the prices specified in the instruments and the settlement prices of futures contracts. Generally, when the applicable settlement price is less than the price specified in the contract, Comstock receives a settlement from the counterparty based on the difference multiplied by the volume or amounts hedged. Similarly, when the applicable settlement price exceeds the price specified in the contract, Comstock pays the counterparty based on the difference. Comstock generally receives a settlement from the counterparty for floors when the applicable settlement price is less than the price specified in the contract, which is based on the difference multiplied by the volume hedged. For collars, generally Comstock receives a settlement from the counterparty when the settlement price is below the floor and pays a settlement to the counterparty when the settlement price exceeds the cap. No settlement occurs when the settlement price falls between the floor and cap.

For the three months and nine months ended September 30, 2009, the Company had natural gas swaps which fixed the price at \$8.00 per Mmbtu (at the Houston Ship Channel) for 520,000 Mmbtu's per month of production. The Company designated these swaps as cash flow hedges. Realized gains of \$7.3 million and \$20.3 million were included in

Table of Contents**COMSTOCK RESOURCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Continued)*

oil and gas sales for the three months and nine months ended September 30, 2009, respectively, related to these swaps. Changes in the fair value of derivative instruments designated as cash flow hedges, to the extent they were effective in offsetting cash flows attributable to the hedged risk, were recorded in other comprehensive income until the hedged item was recognized in earnings. Any change in fair value resulting from ineffectiveness was recognized in oil and gas sales as an unrealized gain or loss. No amounts relating to the hedge ineffectiveness were recognized in oil and gas sales during the three months and nine months ended September 30, 2009. The Company did not have any derivative financial instruments outstanding during the three months or nine months ended September 30, 2010.

Stock-Based Compensation

Comstock accounts for employee stock-based compensation under the fair value method. Compensation cost is measured at the grant date based on the fair value of the award and is recognized over the award vesting period. During the three months ended September 30, 2010 and 2009, the Company recognized \$4.4 million and \$4.0 million, respectively, of stock-based compensation expense within general and administrative expenses related to stock option and restricted stock grants. During the nine months ended September 30, 2010 and 2009, the Company recognized \$12.9 million and \$11.5 million, respectively, of stock-based compensation expense within general and administrative expenses related to stock option and restricted stock grants.

The Company had 246,870 stock options outstanding at September 30, 2010, of which 223,370 were exercisable. Total unrecognized compensation cost related to nonvested stock options of \$0.1 million as of September 30, 2010 is expected to be recognized over a period of 0.2 years. The Company received cash proceeds from the exercise of stock options of \$1.3 million and \$1.5 million for the nine months ended September 30, 2010 and 2009, respectively.

As of September 30, 2010, Comstock had 1,688,000 shares of unvested restricted stock outstanding at a weighted average grant date fair value of \$37.22 per share. Total unrecognized compensation cost related to unvested restricted stock grants of \$31.9 million as of September 30, 2010 is expected to be recognized over a period of 2.5 years. During the nine months ended September 30, 2010, the Company awarded a total of 36,000 shares of restricted stock to its independent directors which will vest three years from the date of grant. The grant date fair value was \$30.49 per share for the 2010 awards.

Income Taxes

The following is an analysis of consolidated income tax expense:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	<i>(In thousands)</i>			
Current benefit	\$ (382)	\$ (26,495)	\$ (199)	\$ (30,618)
Deferred provision	174	24,302	131	22,318
Benefit from income taxes	\$ (208)	\$ (2,193)	\$ (68)	\$ (8,300)

Table of Contents

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Deferred income taxes are provided to reflect the future tax consequences or benefits of differences between the tax basis of assets and liabilities and their reported amounts in the financial statements using enacted tax rates. The difference between the Company's customary rate of 35% and the effective tax rate on income before income taxes is due to the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Tax at statutory rate	35.0%	35.0%	35.0%	35.0%
Tax effect of:				
Nondeductible stock-based compensation	(26.6%)	(14.5%)	(11.9%)	(10.6%)
State income taxes, net of federal benefit	(3.1%)	(3.7%)	9.0%	(1.2%)
Net operating loss carryback adjustments	%	%	(38.7%)	%
Other	(1.0%)	(1.9%)	(0.5%)	(1.4%)
Effective tax rate	4.3%	14.9%	(7.1%)	21.8%

In determining the 2010 full year effective tax rate, the Company is projecting a pre-tax loss. The Company's non-deductible stock-based compensation has the effect of lowering the Company's annualized expected tax benefit. In addition, the 2010 effective tax rate reflects a benefit from adjustments related to refund claims resulting from the finalized net operating loss carrybacks in the Company's 2009 tax returns.

The Company's income tax returns in major state income tax jurisdictions remain subject to examination from various periods subsequent to December 31, 2005. State tax returns in two state jurisdictions are currently under review. The Company has evaluated the preliminary findings in these jurisdictions and believes it is more likely than not that the ultimate resolution of these matters will not have a material impact on its financial statements. The Company currently believes that all other significant filing positions are highly certain and that all of its other significant income tax positions and deductions would be sustained under audit therefore the Company has no significant reserves for uncertain tax positions.

Fair Value Measurements

As of September 30, 2010, the Company held certain items that are required to be measured at fair value. These included cash equivalents held in money market funds and marketable securities comprised of shares of Stone Energy Corporation common stock. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The estimated fair value for the items in the Company's financial statement were based on Level 1 inputs where the inputs used to measure fair value are unadjusted quoted prices that are available in active markets for the identical assets or liabilities as of the reporting date.

The following table summarizes financial assets and liabilities accounted for at fair value as of September 30, 2010:

**Carrying
Value
Measured
at Fair Value**
*(In
thousands)*

Items measured at fair value on a recurring basis:

Cash equivalents money market funds	\$	4,350
Marketable securities		70,661
Total assets	\$	75,011

Table of Contents

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

The following table presents the carrying amounts and estimated fair value of the Company's other financial instruments as of September 30, 2010 and December 31, 2009:

	As of September 30,		As of December 31, 2009	
	2010			
	Carrying	Fair	Carrying	Fair
	Value	Value	Value	Value
	<i>(In thousands)</i>			
Long-term debt, including current portion	\$ 528,238	\$ 538,750	\$ 470,836	\$ 479,938

The fair market value of the Company's fixed rate debt was based on their market prices as of September 30, 2010 and December 31, 2009. The fair value of the Company's floating rate debt approximates its carrying value.

Earnings Per Share

Basic earnings per share is determined without the effect of any outstanding potentially dilutive stock options and diluted earnings per share is determined with the effect of outstanding stock options that are potentially dilutive. Unvested share-based payment awards containing nonforfeitable rights to dividends are considered to be participatory securities and are included in the computation of basic and diluted earnings per share pursuant to the two-class method. Basic and diluted earnings per share for the three months and nine months ended September 30, 2010 and 2009, respectively, were determined as follows: