

COMSTOCK RESOURCES INC

Form 10-Q

August 03, 2012

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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 June 30, 2012

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)

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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 ☐ Smaller reporting company ☐
(Do not check if a 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 \$0.50, as of August 3, 2012 was 48,161,696.

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COMSTOCK RESOURCES, INC.

QUARTERLY REPORT

For the Quarter Ended June 30, 2012

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

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| | June 30, 2012 | December 31, 2011 |
|--|------------------|----------------------|
| | (In thousands) | |
| ASSETS | | |
| Cash and Cash Equivalents | \$ 3,505 | \$ 8,460 |
| Accounts Receivable: | | |
| Oil and gas sales | 34,655 | 47,082 |
| Joint interest operations | 7,467 | 6,651 |
| Marketable Securities | 15,204 | 47,642 |
| Derivative Financial Instruments | 18,536 | 459 |
| Other Current Assets | 6,695 | 2,796 |
| Total current assets | 86,062 | 113,090 |
| Property and Equipment: | | |
| Unevaluated oil and gas properties | 362,676 | 369,096 |
| Oil and gas properties, successful efforts method | 3,519,016 | 3,476,146 |
| Other | 18,598 | 18,062 |
| Accumulated depreciation, depletion and amortization | (1,353,071) | (1,353,459) |
| Net property and equipment | 2,547,219 | 2,509,845 |
| Derivative Financial Instruments | 6,235 | |
| Other Assets | 21,796 | 16,949 |
| | \$ 2,661,312 | \$ 2,639,884 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Accounts Payable | \$ 95,691 | \$ 94,041 |
| Deferred Income Taxes | 8,762 | 7,664 |
| Accrued Expenses | 72,273 | 85,502 |
| Total current liabilities | 176,726 | 187,207 |
| Long-term Debt | 1,223,235 | 1,196,908 |
| Deferred Income Taxes | 203,530 | 201,705 |
| Reserve for Future Abandonment Costs | 14,191 | 13,997 |
| Other Non-Current Liabilities | 2,337 | 2,442 |
| Total liabilities | 1,620,019 | 1,602,259 |
| Commitments and Contingencies | | |
| Stockholders' Equity: | | |
| Common stock \$0.50 par, 75,000,000 shares authorized, 48,161,696 and 48,125,296 shares outstanding at June 30, 2012 and December 31, 2011, respectively | 24,081 | 24,063 |
| Additional paid-in capital | 473,881 | 468,709 |
| Retained earnings | 520,932 | 524,377 |
| Accumulated other comprehensive income | 22,399 | 20,476 |
| Total stockholders' equity | 1,041,293 | 1,037,625 |

\$ 2,661,312 \$ 2,639,884

The accompanying notes are an integral part of these statements.

Table of Contents**COMSTOCK RESOURCES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|-----------------|----------------------------------|-----------------|
| | 2012 | 2011 | 2012 | 2011 |
| | <i>(In thousands, except per share amounts)</i> | | | |
| Revenues: | | | | |
| Oil and gas sales | \$ 104,690 | \$ 112,451 | \$ 215,025 | \$ 200,489 |
| Gain on sale of oil and gas properties | 20,338 | | 27,065 | |
| Total revenues | 125,028 | 112,451 | 242,090 | 200,489 |
| Operating expenses: | | | | |
| Production taxes | 3,380 | 1,363 | 7,017 | 2,089 |
| Gathering and transportation | 7,338 | 6,611 | 15,230 | 12,239 |
| Lease operating | 13,948 | 12,437 | 28,697 | 23,985 |
| Exploration | 37 | 82 | 1,390 | 9,619 |
| Depreciation, depletion and amortization | 90,083 | 74,689 | 169,180 | 135,014 |
| Impairment of oil and gas properties | 5,301 | | 5,350 | |
| Loss on sale of oil and gas properties | | (26) | | 83 |
| General and administrative, net | 9,033 | 8,917 | 17,831 | 17,345 |
| Total operating expenses | 129,120 | 104,073 | 244,695 | 200,374 |
| Operating income (loss) | (4,092) | 8,378 | (2,605) | 115 |
| Other income (expenses): | | | | |
| Interest expense | (14,529) | (10,410) | (27,766) | (20,694) |
| Gain on sale of marketable securities | | 8,480 | 26,621 | 29,729 |
| Other income | 545 | 83 | 522 | 393 |
| Total other income (expenses) | (13,984) | (1,847) | (623) | 9,428 |
| Income (loss) before income taxes | (18,076) | 6,531 | (3,228) | 9,543 |
| Benefit from (provision for) income taxes | 7,772 | (2,582) | (217) | (3,190) |
| Net income (loss) | \$ (10,304) | \$ 3,949 | \$ (3,445) | \$ 6,353 |
| Net income (loss) per share: | | | | |
| Basic | \$ (0.22) | \$ 0.08 | \$ (0.07) | \$ 0.13 |
| Diluted | \$ (0.22) | \$ 0.08 | \$ (0.07) | \$ 0.13 |
| Weighted average shares outstanding: | | | | |
| Basic | 46,426 | 45,992 | 46,399 | 45,983 |
| Diluted | 46,426 | 45,992 | 46,399 | 45,983 |

The accompanying notes are an integral part of these statements.

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COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--|-------------|--------------------------------------|-------------|
| | 2012 | 2011 | 2012 | 2011 |
| | <i>(In thousands)</i> | | | |
| Net income (loss) | \$ (10,304) | \$ 3,949 | \$ (3,445) | \$ 6,353 |
| Unrealized hedging gains, net of provision for income taxes of (\$12,087), \$, (\$8,509) and \$ | 22,448 | | 15,803 | |
| Net change in unrealized gains on marketable securities, net of benefit from income taxes of \$682, \$5,276, \$7,475 and \$2,154 | (1,268) | (9,797) | (13,880) | (3,999) |
| Other comprehensive income (loss) | 21,180 | (9,797) | 1,923 | (3,999) |
| Comprehensive income (loss) | \$ 10,876 | \$ (5,848) | \$ (1,522) | \$ 2,354 |

The accompanying notes are an integral part of these statements.

Table of Contents**COMSTOCK RESOURCES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY****For the Six Months Ended June 30, 2012****(Unaudited)**

| | Common Stock (Shares) | Common Stock Par Value | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income | Total |
|---|--------------------------------------|---------------------------------------|---|------------------------------|---|--------------|
| | <i>(In thousands)</i> | | | | | |
| Balance at January 1, 2012 | 48,125 | \$ 24,063 | \$ 468,709 | \$ 524,377 | \$ 20,476 | \$ 1,037,625 |
| Stock-based compensation | 37 | 18 | 6,842 | | | 6,860 |
| Excess income taxes from stock-based compensation | | | (1,670) | | | (1,670) |
| Net loss | | | | (3,445) | | (3,445) |
| Other comprehensive income | | | | | 1,923 | 1,923 |
| Balance at June 30, 2012 | 48,162 | \$ 24,081 | \$ 473,881 | \$ 520,932 | \$ 22,399 | \$ 1,041,293 |

The accompanying notes are an integral part of these statements.

Table of Contents**COMSTOCK RESOURCES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

| | Six Months Ended June 30, | |
|--|------------------------------|-----------|
| | 2012 | 2011 |
| | (In thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | \$ (3,445) | \$ 6,353 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Gain on sale of assets | (53,686) | (29,646) |
| Deferred income taxes | 416 | 2,621 |
| Dry hole costs and lease impairments | 1,315 | 9,454 |
| Impairment of oil and gas properties | 5,350 | |
| Depreciation, depletion and amortization | 169,180 | 135,014 |
| Debt issuance cost and discount amortization | 2,103 | 2,403 |
| Stock-based compensation | 6,860 | 7,012 |
| Excess income taxes from stock-based compensation | 1,670 | 612 |
| (Increase) decrease in accounts receivable | 11,611 | (6,631) |
| Increase in other current assets | (4,097) | (8,454) |
| Increase (decrease) in accounts payable and accrued expenses | 4,621 | (836) |
| Net cash provided by operating activities | 141,898 | 117,902 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (348,337) | (332,537) |
| Proceeds from asset sales | 183,777 | 45,648 |
| Net cash used for investing activities | (164,560) | (286,889) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Borrowings | 390,912 | 465,000 |
| Principal payments on debt | (365,000) | (287,000) |
| Debt issuance costs | (6,535) | (6,577) |
| Excess income taxes from stock-based compensation | (1,670) | (612) |
| Net cash provided by financing activities | 17,707 | 170,811 |
| Net increase (decrease) in cash and cash equivalents | (4,955) | 1,824 |
| Cash and cash equivalents, beginning of period | 8,460 | 1,732 |
| Cash and cash equivalents, end of period | \$ 3,505 | \$ 3,556 |

The accompanying notes are an integral part of these statements.

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COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012

(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 June 30, 2012 and the related results of operations for the three months and six months ended June 30, 2012 and 2011 and cash flows for the six months ended June 30, 2012 and 2011.

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, 2011.

The results of operations for the three months and six months ended June 30, 2012 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.

In connection with a reverse like-kind exchange in accordance with Section 1031 of the Internal Revenue Code, the Company assigned certain oil and gas properties acquired in 2011 to a variable interest entity formed by an exchange accommodation titleholder. The Company operated these properties pursuant to lease and management agreements with that entity, and had a call option which allowed the Company to terminate the exchange transaction at any time up and until the expiration date of the exchange. Because the Company was the primary beneficiary of these arrangements, the properties acquired are included in its consolidated balance sheets as of December 31, 2011 and all revenues and expenses incurred related to the properties are included in the Company's consolidated results of operations for the three months and six months ended June 30, 2012. The Company completed the reverse like-kind exchange in May 2012 after completing the planned divestiture of certain oil and gas properties. The ownership of all of the assets held by the variable interest entity was transferred to one of the Company's wholly owned subsidiaries.

Reclassifications

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

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COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

Marketable Securities

As of June 30, 2012, the Company held 600,000 shares of Stone Energy Corporation common stock which was reflected in the consolidated balance sheet as marketable securities. As of June 30, 2012, the cost basis of the marketable securities was \$5.5 million and the estimated fair value was \$15.2 million, after recognizing an unrealized gain after income taxes of \$6.3 million. The Company utilizes the specific identification method to determine the cost of any securities sold. During the six months ended June 30, 2012, the Company sold 1,206,000 shares of Stone Energy Corporation common stock and received proceeds of \$37.7 million. Comstock realized a gain before income taxes of \$26.6 million on the sales for six months ended June 30, 2012, which is included in other income in the consolidated statements of operations. The Company had no sales of Stone Energy Corporation common stock during the three months ended June 30, 2012. During the three months and six months ended June 30, 2011 the Company sold 370,000 and 1,741,000 shares, respectively, of Stone common stock for proceeds of \$11.9 million and \$45.7 million, respectively, and realized a gain before income taxes of \$8.5 million and \$29.7 million, respectively, for the three months and six months ended June 30, 2011.

Property and Equipment

The Company follows the successful efforts method of accounting for its oil and natural gas properties. Costs incurred to acquire oil and gas leasehold are capitalized.

Unproved oil and gas properties are periodically assessed and any impairment in value is charged to exploration expense. The costs of unproved properties which are determined to be productive are transferred to oil and gas properties and amortized on an equivalent unit-of-production basis. During the six months ended June 30, 2012 and 2011, the Company's assessment of its unevaluated acreage indicated that certain leases were expected to expire prior to the Company conducting drilling operations. Accordingly, impairment charges for these unevaluated properties of \$1.3 million and \$9.5 million were recognized in exploration expense during the six months ended June 30, 2012 and 2011, respectively.

The Company also assesses the need for an impairment of the costs capitalized for its oil and gas properties on a property or cost center basis. The Company recognized impairment charges related to certain minor oil and gas fields of \$5.4 million during the six months ended June 30, 2012. There were no impairment charges related to the Company's oil and gas properties recognized during the three months and six months ended June 30, 2011.

During the three months ended June 30, 2012, the Company completed the sale of certain oil and gas properties located in Tyler and Polk counties in South Texas and Lincoln Parish in North Louisiana which had been reported as assets held for sale as of March 31, 2012. The Company received net proceeds of \$112.7 million and recognized a net gain on disposal of \$20.3 million from this transaction. During the three months ended June 30, 2012, the Company also completed the sale of certain non-operated oil and gas properties in Reeves County, Texas and received net proceeds of \$24.8 million. The Company has accounted for the disposal of these properties as a retirement since they represented a small portion of the assets within one of its major oil and gas properties.

The Company prepares interim estimates of crude oil and natural gas reserves at the end of each quarter as part of its quarterly close process. These interim estimates, which are not audited by independent petroleum engineers, are prepared using procedures that are consistent with those used in the Company's year-end reserves estimates. During the three months ended June 30, 2012, the twelve month rolling average first of the month price for natural gas decreased 24% below the comparable price used to estimate natural gas reserve quantities as of December 31, 2011. As a result of this significant price decline, the Company's estimated quantities of proved undeveloped natural gas reserves have decreased by approximately 330 billion cubic feet, or 59%, from total proved undeveloped reserves as of December 31, 2011. This decrease represented approximately 30% of total proved reserves as of December 31, 2011. The decrease in proved undeveloped natural gas reserves during the three months ended June 30, 2012 resulted in an increase to the Company's per unit amortization rate for its proved oil and gas properties and increased depletion, depreciation and amortization expense during this period as compared to previous periods. The changes in proved undeveloped reserves did not have a significant effect on the Company's standardized measure of future cash flows and they did not have a

material impact on the Company's assessment of impairment during the three months ended June 30, 2012.

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

Accrued expenses at June 30, 2012 and December 31, 2011 consist of the following:

| | As of June 30, 2012 | As of December 31, 2011 |
|--|---------------------------|-------------------------------|
| | <i>(In thousands)</i> | |
| Accrued oil and gas property acquisition costs | \$ 8,572 | \$ 31,988 |
| Accrued drilling costs | 35,980 | 29,291 |
| Accrued interest | 13,235 | 11,113 |
| Other accrued expenses | 14,486 | 13,110 |
| | \$ 72,273 | \$ 85,502 |

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 six months ended June 30, 2012 and 2011:

| | Six Months Ended June 30, 2012 | 2011 |
|---|--------------------------------------|----------|
| | <i>(In thousands)</i> | |
| Beginning future abandonment costs | \$ 13,997 | \$ 6,674 |
| Accretion expense | 350 | 186 |
| New wells placed on production and changes in estimates | 944 | 191 |
| Liabilities settled and assets disposed of | (1,100) | (42) |
| Future abandonment costs end of period | \$ 14,191 | \$ 7,009 |

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 June 30, 2012 or December 31, 2011.

Derivative Financial Instruments and Hedging Activities

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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. For swaps, 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 swap 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 volumes 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.

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

All of the Company's derivative financial instruments at June 30, 2012 and December 31, 2011 were designed as effective cash flow hedges. As of June 30, 2012, the Company had the following outstanding commodity derivatives:

| Commodity and Derivative Type | Weighted-Average Contract Price | Volume | Contract Period | |
|--------------------------------------|--|---------------|------------------------|-----------|
| Crude Oil Price Swap Agreements | \$ 99.53 per Bbl. | 900 Mbbl | July 2012 | Dec. 2012 |
| Crude Oil Price Swap Agreements | \$ 100.33 per Bbl. | 1,080 Mbbl | Jan. 2013 | Dec. 2013 |

Realized gains and losses related to derivative financial instruments that are designated as cash flow hedges are included in oil and natural gas sales in the month of production. Changes in the fair value of derivative instruments designated as cash flow hedges to the extent they are effective in offsetting cash flows attributable to the hedged risk are recorded in other comprehensive income (loss) until the hedged item is recognized in earnings. Any change in fair value resulting from ineffectiveness is recognized currently in other income (expenses). The Company realized gains of \$2.7 million and \$1.4 million before income taxes on crude oil price swaps during the three months and six months ended June 30, 2012, respectively. As of June 30, 2012 the estimated fair value of the Company's derivative financial instruments, which equals their carrying value, was an asset of \$24.8 million, of which \$18.5 million was classified as current and \$6.3 million was classified as long-term, based on estimated settlement dates.

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 June 30, 2012 and 2011, the Company recognized \$3.4 million and \$3.9 million, respectively, of stock-based compensation expense within general and administrative expenses related to awards of restricted stock to its employees and directors. During the six months ended June 30, 2012 and 2011, the Company recognized \$6.9 million and \$7.0 million, respectively, of stock-based compensation expense within general and administrative expenses related to awards of restricted stock and stock options.

As of June 30, 2012, Comstock had 1,718,945 shares of unvested restricted stock outstanding at a weighted average grant date fair value of \$29.38 per share. Total unrecognized compensation cost related to unvested restricted stock grants of \$50.5 million as of June 30, 2012 is expected to be recognized over a period of 2.1 years. During the six months ended June 30, 2012 the Company awarded a total of 50,500 shares of restricted stock to its independent directors. The grant date fair value was \$17.03 per share for the 2012 awards.

As of June 30, 2012, Comstock had outstanding options to purchase 157,150 shares of common stock at a weighted average exercise price of \$38.36 per share. All of the stock options were exercisable and there were no unrecognized costs related to the stock options as of June 30, 2012. No stock options were exercised during the six months ended June 30, 2012 or June 30, 2011.

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

The following is an analysis of consolidated income tax expense:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|-------------|--------------------------------------|-------------|
| | 2012 | 2011 | 2012 | 2011 |
| | <i>(In thousands)</i> | | | |
| Current provision (benefit) | \$ (116) | \$ 410 | \$ (199) | \$ 569 |
| Deferred provision (benefit) | (7,656) | 2,172 | 416 | 2,621 |
| Provision for (benefit from) income taxes | \$ (7,772) | \$ 2,582 | \$ 217 | \$ 3,190 |

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 June 30, | | Six Months Ended June 30, | |
|--|--|-------------|--------------------------------------|-------------|
| | 2012 | 2011 | 2012 | 2011 |
| Tax at statutory rate | 35.0% | 35.0% | 35.0% | 35.0% |
| Tax effect of: | | | | |
| Nondeductible stock-based compensation | 4.7% | 4.3% | (33.8%) | (2.0%) |
| State income taxes, net of federal benefit | 2.9% | (0.1%) | (5.3%) | 0.2% |
| Other | 0.4% | 0.3% | (2.6%) | 0.2% |
| Effective tax rate | 43.0% | 39.5% | (6.7%) | 33.4% |

The Company's non-deductible stock-based compensation has the effect of increasing the Company's annualized effective tax rate in the case of a provision or reducing the effective tax rate in the case of a benefit.

The Company's income tax returns in major state income tax jurisdictions remain subject to examination from various periods subsequent to December 31, 2006. 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 effect 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 or the final resolution would not have a material effect on the consolidated financial statements. Therefore, the Company has not established any significant reserves for uncertain tax positions.

Fair Value Measurements

The Company holds certain items that are required to be measured at fair value. These include cash equivalents held in bank accounts, marketable securities comprised of shares of Stone Energy Corporation common stock, and derivative financial instruments in the form of oil or natural gas price swap agreements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit

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price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A three-level hierarchy is followed for disclosure to show the extent and level of judgment used to estimate fair value measurements:

Level 1 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.

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

Level 2 Inputs used to measure fair value, other than quoted prices included in Level 1, are either directly or indirectly observable as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the financial instrument.

Level 3 Inputs used to measure fair value are unobservable inputs that are supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

The Company's cash and marketable securities valuation are based on Level 1 measurements. The Company's oil price swap agreements were not traded on a public exchange, and their value was determined utilizing a discounted cash flow model based on inputs that are readily available in public markets and, accordingly, the valuation of these swap agreements was categorized as a Level 2 measurement.

The following table summarizes financial assets accounted for at fair value as of June 30, 2012:

| | Carrying Value Measured at Fair Value at June 30, 2012 | Level 1 <i>(In thousands)</i> | Level 2 |
|---|--|----------------------------------|-----------|
| Assets measured at fair value on a recurring basis: | | | |
| Cash held in bank accounts | \$ 3,505 | \$ 3,505 | \$ |
| Marketable securities | 15,204 | 15,204 | |
| Derivative financial instruments | 24,771 | | 24,771 |
| Total assets | \$ 43,480 | \$ 18,709 | \$ 24,771 |

The following table summarizes the changes in the fair values of derivative financial instruments, which are Level 2 assets, for the three months and six months ended June 30, 2012:

**Three Months
Ended
June 30, 2012**