COMSTOCK RESOURCES INC
Form 10-Q
November 09, 2018

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, 2018

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	94-1667468
(State or other jurisdiction of incorporation or organization)	(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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
Emerging growth company			

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 November 8, 2018 was 105,871,064.

COMSTOCK RESOURCES, INC.

QUARTERLY REPORT

For the Quarter Ended September 30, 2018

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Item 6. Exhibits

EX-31.1 Section 302 Certification of the Chief Executive Officer.
EX-31.2 Section 302 Certification of the Chief Financial Officer.
EX-32.1 Certification for the Chief Executive Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002.
EX-32.2 Certification for the Chief Financial Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002.
EX-101 Instance Document
EX-101 Schema Document
EX-101 Calculation Linkbase Document
EX-101 Labels Linkbase Document
EX-101 Presentation Linkbase Document
EX-101 Definition Linkbase Document

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

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COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

ASSETS	Successor September 30, 2018	Predecessor December 31, 2017
	(In thousands)	
Cash and Cash Equivalents	$31,780	$61,255
Accounts Receivable:		
Oil and gas sales	61,003	26,700
Joint interest operations	19,619	11,872
Derivative Financial Instruments	—	1,318
Assets Held For Sale	—	198,615
Other Current Assets	19,070	2,745
Total current assets	131,472	302,505
Property and Equipment:		
Oil and gas properties, successful efforts method		
Proved	1,568,504	2,631,750
Unproved	195,178	—
Other	4,440	18,918
Accumulated depreciation, depletion and amortization	(174,520)	(2,042,739)
Net property and equipment	1,593,602	607,929
Goodwill	349,667	—
Income Taxes Receivable	19,086	19,086
Other Assets	549	899
	$2,094,376	$930,419

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

Accounts Payable	$124,008	$126,034
Accrued Expenses	53,261	42,455
Derivative Financial Instruments	2,849	—
Total current liabilities	180,118	168,489
Long-term Debt	1,242,844	1,110,529
Deferred Income Taxes	145,565	10,266
Reserve for Future Abandonment Costs	4,738	10,407
Total liabilities	1,573,265	1,299,691
Commitments and Contingencies		
Stockholders' Equity (Deficit):		
	52,940	7,714

Common stock — $0.50 par, 155,000,000 shares authorized, 105,879,064 shares issued and outstanding at September 30, 2018, 75,000,000 authorized, 15,427,561 shares issued and outstanding as of December 31, 2017		
Common stock warrants	—	3,557
Additional paid-in capital	454,348	546,696
Accumulated earnings (deficit)	13,823	(927,239)
Total stockholders' equity (deficit)	521,111	(369,272)
	$2,094,376	$930,419

The accompanying notes are an integral part of these statements.

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30, Transition Period			Nine Months Ended September 30, Transition Period		
	Successor	Predecessor	Predecessor	Successor	Predecessor	Predecessor
	For the Period from August 14, 2018 through September 30, 2018	For the Period from July 1, 2018 through August 13, 2018	2017	For the Period from August 14, 2018 through September 30, 2018	For the Period from January 1, 2018 through August 13, 2018	2017
	(In thousands, except per share amounts)					
Revenues:						
Natural gas sales	$36,393	$ 32,089	$ 56,164	$36,393	$ 147,897	$ 147,541
Oil sales	33,730	499	10,647	33,730	18,733	34,542
Total oil and gas sales	70,123	32,588	66,811	70,123	166,630	182,083
Operating expenses:						
Production taxes	4,051	707	1,490	4,051	3,659	3,730
Gathering and transportation	3,450	3,109	4,755	3,450	11,841	12,428
Lease operating	7,016	3,418	9,359	7,016	21,139	28,681
Depreciation, depletion and amortization	17,820	14,082	32,783	17,820	68,032	93,009
General and administrative	3,303	3,044	6,174	3,303	15,699	19,134
Loss (gain) on sale of oil and gas properties	(98)	—	1,060	(98)	35,438	1,060
Total operating expenses	35,542	24,360	55,621	35,542	155,808	158,042
Operating income	34,581	8,228	11,190	34,581	10,822	24,041
Other income (expenses):						
Gain (loss) from derivative financial instruments	(2,015)	(83)	1,430	(2,015)	881	14,585

Other income	42	284	170	42	677	398
Interest expense	(14,845)	(22,140)	(37,595)	(14,845)	(101,203)	(107,250)
Transaction costs	—	(2,549)	—	—	(2,866)	—
Total other income (expenses)	(16,818)	(24,488)	(35,995)	(16,818)	(102,511)	(92,267)
Income (loss) before income taxes	17,763	(16,260)	(24,805)	17,763	(91,689)	(68,226)
Benefit from (provision for) income taxes	(3,940)	(605)	69	(3,940)	(1,065)	(883)
Net income (loss)	$ 13,823	$ (16,865)	$ (24,736)	$ 13,823	$ (92,754)	$ (69,109)
Net income (loss) per share – basic and diluted	$ 0.13	$ (1.09)	$ (1.67)	$ 0.13	$ (6.08)	$ (4.74)
Weighted average shares outstanding –						
Basic	105,448	15,468	14,796	105,448	15,262	14,591
Diluted	105,463	15,468	14,796	105,463	15,262	14,591

The accompanying notes are an integral part of these statements.

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)

(Unaudited)

	Common Stock (Shares)	Common Stock – Par Value	Common Stock Warrants	Additional Paid-in Capital	Accumulated Earnings (Deficit)	Total
	(In thousands)					
Predecessor Company:						
Balance at January 1, 2018	15,428	$ 7,714	$ 3,557	$ 546,696	$ (927,239)	$ (369,272)
Stock-based compensation	623	311	—	3,601	—	3,912
Income tax withholdings related to equity awards	(53)	(26)	—	(343)	—	(369)
Common stock warrants exercised	379	189	(3,247)	3,058	—	—
Common stock issued for debt conversions	2	1	—	28	—	29
Net loss	—	—	—	—	(92,754)	(92,754)
Balance at August 13, 2018	16,379	$ 8,189	$ 310	$ 553,040	$ (1,019,993)	$ (458,454)
Successor Company:						
Successor common stock	16,379	$ 8,189	$ 310	$ 132,032	$ —	$ 140,531
Vesting of equity awards	1,029	514	—	8,312	—	8,826
Income tax withholdings related to equity awards	(547)	(272)	—	(4,423)	—	(4,695)
Jones contribution	88,571	44,286	—	318,406	—	362,692
Stock-based compensation	423	211	—	118	—	329

Stock issuance costs	—	—	—	(395)	—	(395)
Common stock warrants exercised and expired	24	12	(310)	298	—	—
Net income	—	—	—	—	13,823	13,823
Balance at September 30, 2018	105,879	$ 52,940	$ —	$ 454,348	$ 13,823	$ 521,111

The accompanying notes are an integral part of these statements.

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Transition Period Successor For the Period from August 14, 2018 through September 30, 2018	Predecessor For the Period from January 1, 2018 through August 13, 2018	Predecessor Nine Months Ended September 30, 2017
		(In thousands)	
Cash Flows from Operating Activities:			
Net income (loss)	$13,823	$(92,754)	$(69,109)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Deferred income taxes	3,883	1,052	768
Loss (gain) on sale of oil and gas properties	(98)	35,438	1,060
Depreciation, depletion and amortization	17,820	68,032	93,009
(Gain) loss on derivative financial instruments	2,015	(881)	(14,585)
Cash settlements of derivative financial instruments	191	2,842	5,352
Amortization of debt discount, premium and issuance costs	822	29,457	24,914
Interest paid in-kind	—	25,004	28,194
Stock-based compensation	329	3,912	4,455
Decrease (increase) in accounts receivable	(44,884)	2,834	(11,952)
Decrease (increase) in other current assets	(1,326)	337	(670)
Increase in accounts payable and accrued expenses	11,034	10,462	29,327
Net cash provided by operating activities	3,609	85,735	90,763
Cash Flows From Investing Activities:			
Acquisitions and capital expenditures	(59,017)	(150,106)	(132,493)
Prepaid drilling costs	(4,768)	(3,692)	—
Proceeds from sale of oil and gas properties	13,739	103,593	1,528
Net cash used for investing activities	(50,046)	(50,205)	(130,965)

Cash Flows from Financing Activities:			
Borrowings	450,000	865,577	—
Retirement of long-term debt	(1,291,352)	(49,679)	—
Jones contribution	36,365	—	—
Common stock warrants exercised	—	—	2
Debt and stock issuance costs	(6,288)	(18,127)	—
Income taxes related to equity awards	(4,695)	(369)	(312)
Net cash provided by (used for) financing activities	(815,970)	797,402	(310)
Net increase (decrease) in cash and cash equivalents	(862,407)	832,932	(40,512)
Cash and cash equivalents, beginning of period	894,187	61,255	65,904
Cash and cash equivalents, end of period	$ 31,780	$ 894,187	$ 25,392

The accompanying notes are an integral part of these statements.

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(Unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES –

Basis of Presentation

These unaudited consolidated financial statements include the accounts of Comstock and its wholly-owned subsidiaries. In management's opinion, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly the financial position of Comstock Resources, Inc. and its subsidiaries (collectively, "Comstock" or the "Company") as of September 30, 2018, and the related results of operations and cash flows for the Predecessor and Successor periods being presented. Net loss and comprehensive loss are the same in all periods presented. All adjustments are of a normal recurring nature unless otherwise disclosed.

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, 2017.

The results of operations for the Predecessor and Successor periods up to and through September 30, 2018 are not necessarily an indication of the results expected for the full year.

On August 14, 2018, Arkoma Drilling, L.P. and Williston Drilling, L.P. (collectively, the "Jones Partnerships") contributed certain oil and gas properties in North Dakota and Montana (the "Bakken Shale Properties") in exchange for common stock representing 84% of the Company's outstanding common stock (the "Jones Contribution"). The Jones Partnerships are wholly owned and controlled by Dallas businessman Jerry Jones and his children (collectively, the "Jones Group"). The Jones Partnerships received 88,571,429 newly issued shares of common stock based on an agreed upon share price of $7.00 per share.

The Company assessed the Bakken Shale Properties to determine whether they meet the definition of a business under US generally accepted accounting principles, determining that they do not meet the definition of a business. As a result, the Jones Contribution is not being accounted for as a business combination. Upon the issuance of the shares of Comstock common stock, the Jones Group obtained control over Comstock through their ownership of the Jones Partnerships. Through the Jones Partnerships, the Jones Group owns a majority of the voting common stock as well as the ability to control the composition of the majority of the board of directors of Comstock. As a result of the change of control that occurred upon the issuance of the common stock, the Jones Group controls Comstock and, thereby, continues to control the Bakken Shale Properties.

Accordingly, the basis of the Bakken Shale Properties recognized by Comstock is the historical basis of the Jones Group. The historical cost basis of the Bakken Shale properties contributed was $397.6 million, which was comprised of $554.3 million of capitalized costs less $156.7 million of accumulated depletion, depreciation and amortization. The change in control of Comstock results in a new basis for Comstock as the company has elected to apply pushdown accounting pursuant to ASC 805, Business Combinations. The new basis is pushed down to Comstock for financial reporting purposes, resulting in Comstock's assets, liabilities and equity accounts being recognized at fair value upon the closing of the Jones Transactions.

References to "Successor" or "Successor Company" relate to the financial position and results of operations of the Company subsequent to August 13, 2018. Reference to "Predecessor" or "Predecessor Company" relate to the financial position and results of operations of the Company on or prior to August 13, 2018. The Company's consolidated financial statements and related footnotes are presented with a black line division which delineates the lack of comparability between amounts presented after August 13, 2018 and dates prior thereto.

The estimated fair value of Comstock's assets and liabilities and the resulting goodwill at the date of the transaction were as follows:

	(In thousands)
Fair Value of Comstock's common stock	$149,357
Fair Value of Liabilities Assumed —	
Current Liabilities	180,452
Long-Term Debt	2,059,560
Deferred Income Taxes	63,708
Reserve for Future Abandonment Costs	4,440
Net Liabilities Assumed	2,308,160
Fair Value of Assets Acquired —	
Current Assets	936,026
Oil and Gas Properties	1,147,749
Other Property & Equipment	4,440
Income Taxes Receivable	19,086
Other Assets	549
Total Assets	2,107,850
Goodwill	$349,667

The table above represents the preliminary allocation of fair value related to the assets acquired and the liabilities assumed based on the fair value of Comstock. Certain data necessary to complete the fair value allocation is not yet available or is in the process of being finalized, and includes, but is not limited to, final income tax returns. We expect to complete the purchase price allocation during the twelve month period following the Jones Contribution date, during which time the value of the assets and liabilities, including goodwill, may be revised as appropriate.

Goodwill recognized is primarily attributable to the excess of the fair value of Comstock's common stock over the identifiable assets acquired net of liabilities assumed, measured in accordance with generally accepted accounting principles in the United States. The fair value of oil and gas properties, a Level 3 measurement, was determined using discounted cash flow valuation methodology. Key inputs to the valuation included average oil prices of $79.72 per barrel, average natural gas prices of $3.87 per thousand cubic feet and discount factors of 10% - 25%. The combination of the Bakken Shale Properties with Comstock's Haynesville shale properties results in a Company with adequate resources and liquidity to fully exploit its Haynesville/Bossier shale asset base and to continue to expand its opportunity set with future acquisitions and leasing activity in the basin.

Transaction-related costs (i.e., advisory, legal, accounting, valuation, other professional or consulting fees) totaling approximately $2.6 million are not included as a component of consideration transferred but are accounted for as expenses in the predecessor periods in which the costs are incurred and the services received. Costs incurred associated with the issuance of common stock have been accounted for as a reduction of additional paid-in capital.

The successful closing of the Jones Contribution triggered payment of an aggregate of $8.1 million including success fees to financial advisors and certain other fees under our licenses for technical data. These costs were contingent on the consummation of the transactions, all of which were interdependent and all of which had to close in order to meet the legal requirements of the contribution agreement. None of these fees would have been incurred otherwise. The Jones Contribution also caused a change in control, upon which restricted shares granted to employees and directors vested, and performance share units granted to executive officers vested at the maximum number of shares granted. The Company had previously recognized stock-based compensation expense of $7.2 million related to these restricted shares and performance share units. The Company did not recognize an expense for the remaining $11.9 million of unrecognized stock-based compensation expense. The Company's accounting policy for any cost triggered by the consummation of the Jones Contribution was to recognize the cost when the Jones Contribution was consummated. Accordingly, unrecognized stock-based compensation expense has not been recorded in the Consolidated Statement of Operations for the Predecessor period since that statement depicts the results of operations just prior to consummation of the transaction. In addition, since the Successor period reflects the effects of push-down accounting, these costs have also not been recorded as an expense in the Successor period. These costs are being considered in the purchase accounting adjustments in arriving at the fair value of the liabilities assumed since they were incurred only in the event the transactions successfully closed, and they are not clearly identifiable to operations either prior to or subsequent to the Jones Contribution.

Under the terms of the Jones Contribution, April 1, 2018 was the effective date for allocation of revenues and expenses related to net cash of the Bakken Shale Properties, and Comstock will receive $43.2 million related to net cash flow from April 1, 2018 to August 13, 2018 from the Jones Partnerships which has been accounted as part of the Jones Contribution.

These financial statements are presented on the basis of the Bakken Shale Properties being contributed to Comstock in exchange for common stock of Comstock. Comstock is a corporation, which is treated as a taxable C corporation and thus is subject to federal and state income taxes. A deferred tax liability of approximately $77.9 million has been recognized related to the tax basis of the Bakken Shale Properties long-lived assets being less than the book basis in those assets. The recording of this deferred tax liability has been treated as an adjustment to additional paid-in capital in these financial statements. The change in control of Comstock results in a new basis for Comstock as the company is applying pushdown accounting pursuant to ASC 805, Business Combinations. The new basis is pushed down to Comstock for financial reporting purposes, resulting in Comstock's assets, liabilities and equity accounts being recognized at fair value upon the closing of the Jones Contribution. A deferred tax liability, net of valuation allowance, of $52.4 million has been recognized related to the change in the basis for financial reporting purposes as compared to the tax basis of the historical Comstock assets.

The unaudited pro forma financial information presented below sets forth the Company's historical statements of operations for the periods indicated and gives effect to the Jones Contribution and the Company's debt refinancing transactions as if "push down" accounting had been applied as of January 1, 2017. Such information is presented for comparative purposes to the Consolidated Statements of Operations only and does not purport to represent what the Company's results of operations would actually have been had these transactions occurred on the date indicated or to project its results of operations for any future period or date.

	Pro Forma Nine Months Ended September 30,	
	2018 [1]	2017
Revenues:		
Natural gas sales	$196,049	$158,679
Oil sales	194,328	159,812
Total oil and gas sales	390,377	318,491
Operating expenses:		
Production taxes	22,168	16,722
Gathering and transportation	15,291	12,428
Lease operating	44,103	43,309
Depreciation, depletion and	132,234	148,100

amortization		
General and administrative	19,319	19,134
Loss on sale of oil and gas properties	35,340	1,060
Total operating expenses	268,455	240,753
Operating income	121,922	77,738
Other income (expenses):		
Gain (loss) from derivative financial instruments	(1,134)	14,585
Other income	719	398
Interest expense	(80,437)	(89,063)
Total other income (expenses)	(80,852)	(74,080)
Income before income taxes	41,070	3,658
Benefit from (provision for) income taxes	(10,818)	(2,211)
Net Income	$ 30,252	$ 1,447
	$ 0.29	$ 0.01

Net income per share – basic and diluted		
Weighted average shares outstanding –		
Basic	105,448	105,095
Diluted	105,463	105,574

(1) Excludes $2.6 million of transaction costs associated with the Jones Contribution.

Property and Equipment

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

On April 27, 2018, Comstock completed the sale of its producing Eagle Ford shale oil and gas properties in McMullen, LaSalle, Frio, Atascosa, Wilson, and Karnes counties, Texas for $125.0 million. The sale was effective November 1, 2017 and the estimated net cash flow from the properties from November 2017 to April 2018 was paid to the buyer at closing. After the sale, the Company had approximately 8,400 net undeveloped acres that are prospective for Eagle Ford shale development. During the predecessor period January 1, 2018 through August 13, 2018, the Company recognized a loss on sale of oil and gas properties of $32.7 million to reduce the carrying value of its assets held for sale to their fair value less costs to sell and to adjust the carrying value of the undeveloped acreage retained to their then fair value of $55.0 million which has been included in proved oil and gas properties. The fair value of the oil and gas properties retained, a Level 3 measurement, was determined using the discounted cash flow valuation methodology applied by Comstock in assessing oil and gas properties for impairment. Key inputs to the valuation included average oil prices of $72.03 per barrel, average natural gas prices of $4.31 per thousand cubic feet and discount factors of 20% - 25%. The Company sold part of the Eagle Ford shale undeveloped acreage in September 2018 for $13.7 million. Also included in the loss on sale for the Predecessor period January 1, 2018 through August 13, 2018 is a loss of $2.7 million resulting from a final settlement for a property sale completed in 2012.

Results of operations for properties that were sold were as follows:

	Predecessor Three Months Ended September 30, 2017	Predecessor For the Period from January 1, 2018 through August 13, 2018	Predecessor Nine Months Ended September 30, 2017
Total oil and gas sales	$ 11,079	$ 17,747	$ 36,495
Total operating expenses(1)	(11,664)	(6,134)	(38,262)
Operating income (loss)	$ (585)	$ 11,613	$ (1,767)

(1)Includes direct operating expenses, depreciation, depletion and amortization and exploration expense and excludes interest and general and administrative expense. No depreciation, depletion and amortization expense has been provided for subsequent to the date the assets were designated as held for sale.

On July 31, 2018, the Company acquired oil and gas properties in North Louisiana and Texas for $39.3 million. These properties consist of approximately 23,000 gross acres (12,000 net) and include 120 (26.2 net) producing natural gas wells, 49 (14.7 net) which produce from the Haynesville shale. All of the acreage acquired is held by production. Comstock has identified 112 (31.0 net) potential drilling locations on this acreage of which 21 (17.9 net) would be operated by Comstock.

On August 14, 2018, in connection with the Jones Contribution, the strategic drilling venture previously entered into by the Company and Arkoma Drilling, LP was terminated and Comstock re-acquired working interests in wells drilled under the joint venture for $17.9 million representing the costs paid by Arkoma Drilling, LP.

The Company assesses the need for an impairment of the capitalized costs for its proved oil and gas properties on a property basis. No impairments were recognized to adjust the carrying value of the Company's proved oil and gas properties during any of the periods presented. Unproved oil and gas properties are also periodically assessed and any impairment in value is charged to expense. The costs of unproved properties are transferred to oil and gas properties and amortized on an equivalent unit-of-production basis as wells are drilled on these properties.

The Company determines the fair values of its oil and gas properties using a discounted cash flow model and proved and risk-adjusted probable oil and natural gas reserves. Undrilled acreage can also be valued based on sales transactions in comparable areas. Significant Level 3 assumptions associated with the calculation of discounted future cash flows included in the cash flow model include management's outlook for oil and natural gas prices, production costs, capital expenditures, and future production as well as estimated proved oil and gas reserves and risk-adjusted probable oil and natural gas reserves. Management's oil and natural gas price outlook is developed based on third-party longer-term price forecasts as of each measurement date. The expected future net cash flows are discounted using an appropriate discount rate in determining a property's fair value.

It is reasonably possible that the Company's estimates of undiscounted future net cash flows attributable to its oil and gas properties may change in the future. The primary factors that may affect estimates of future cash flows include future adjustments, both positive and negative, to proved and appropriate risk-adjusted probable oil and gas reserves, results of future drilling activities, future prices for oil and natural gas, and increases or decreases in production and capital costs. As a result of these changes, there may be future impairments in the carrying values of these or other properties.

Goodwill

Goodwill represents the excess of purchase price over fair value of net tangible and identifiable intangible assets related to the Jones Transactions. The Company is not required to amortize goodwill as a charge to earnings; however, the Company is required to conduct an annual review of goodwill for impairment. The Company will perform its first annual review of goodwill impairment starting on October 1, 2019. The Company has goodwill of $349.7 million as of September 30, 2018 that was recorded in connection with the Jones Contribution.

Accrued Expenses

Accrued expenses at September 30, 2018 and December 31, 2017 consist of the following:

	Successor As of September 30, 2018	Predecessor As of December 31, 2017
	(In thousands)	
Accrued drilling costs	$18,811	$ 5,874
Accrued interest payable	14,328	21,277
Accrued transportation costs	5,022	3,269
Accrued employee compensation	3,841	6,449
Accrued ad valorem taxes	5,021	—
Accrued lease operating expenses	3,311	68
Asset retirement obligation – assets held for sale	—	4,557
Other	2,927	961
	$53,261	$ 42,455

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 for such obligations during the periods presented:

	Successor For the Period from August 14, 2018 through September 30, 2018	Predecessor For the Period from January 1, 2018 through August 13, 2018	Predecessor Nine Months Ended September 30, 2017

		(In thousands)	
Future abandonment costs — beginning of period	$ 4,683	$ 10,407	$ 15,804
Accretion expense	45	346	645
New wells placed on production	10	17	5
Liabilities settled and assets disposed of	—	(87)	(356)
Future abandonment costs — end of period	$ 4,738	$ 10,683	$ 16,098

Derivative Financial Instruments and Hedging Activities

All of the Company's derivative financial instruments are used for risk management purposes and, by policy, none are held for trading or speculative purposes. Comstock minimizes credit risk to counterparties of its derivative financial instruments through formal credit policies, monitoring procedures, and diversification. The Company is not required to provide any credit support to its counterparties other than cross collateralization with the assets securing its bank credit facility. None of the Company's derivative financial instruments involve payment or receipt of premiums. The Company classifies the fair value amounts of derivative financial instruments as net current or noncurrent assets or liabilities, whichever the case may be, by commodity and counterparty.

All of Comstock's natural gas derivative financial instruments are tied to the Henry Hub-NYMEX price index and all of its crude oil derivative financial instruments are tied to the WTI-NYMEX index price. The Company had the following outstanding derivative financial instruments for natural gas price risk management at September 30, 2018:

	Future Production Period		
	Three Months Ending December 31, 2018	Year Ending December 31, 2019	Total
Natural Gas Swap contracts:			
Volume (MMbtu)	5,400,000	4,200,000	9,600,000
Average Price per MMbtu	$3.00	$3.00	$3.00
Natural Gas Collar contracts:			
Volume (MMbtu)	6,300,000	13,200,000	19,500,000
Price per MMbtu			
Average Ceiling	$3.40	$3.40	$3.40
Average Floor	$2.50	$2.50	$2.50
Crude Oil Collar contracts:			
Volume (Barrels)	315,000	855,000	1,170,000
Price per Barrel			
Average Ceiling	$77.85	$77.98	$77.94
Average Floor	$55.00	$55.00	$55.00

None of the Company's derivative contracts were designated as cash flow hedges. The aggregate fair value of the Company's derivative instruments reported in the accompanying consolidated balance sheets by type, including the classification between assets and liabilities, consists of the following:

Type	Consolidated Balance Sheet Location	Fair Value	Gross Amounts Offset in the Consolidated Balance Sheet	Net Fair Value Presented in the Consolidated Balance Sheet
			(in thousands)	
Successor Fair Value of Derivative Instruments as of September 30, 2018				
Asset Derivatives:				

Natural gas price derivatives	Derivative Financial Instruments – current	$18	$ (18)	$ —
Liability Derivatives:				
Natural gas price derivatives	Derivative Financial Instruments – current	$854	$ (18)	836
Crude oil price derivatives	Derivative Financial Instruments – current	$2,013	$ —	2,013
				$ 2,849
Predecessor Fair Value of Derivative Instruments as of December 31, 2017				
Asset Derivatives:				
Natural gas price derivatives	Derivative Financial Instruments – current	$1,318	$ —	$ 1,318

The Company recognized cash settlements and changes in the fair value of its derivative financial instruments as a single component of other income (expenses). Gains and losses related to the change in the fair value recognized on the Company's derivative contracts recognized in the consolidated statement of operations were as follows:

Location of Gain/(Loss) Recognized in Earnings on Derivatives	Successor For the Period from August 14, 2018 through September 30, 2018	Predecessor For the Period from July 1, 2018 through August 13, 2018	Predecessor Three Months Ended September 30, 2017	Successor For the Period from August 14, 2018 through September 30, 2018	Predecessor For the Period from January 1, 2018 through August 13, 2018	Predecessor Nine Months Ended September 30, 2017
			(In thousands)			
Gain (loss) from derivative financial instruments	$ (2,015)	$ (83)	$ 1,430	$ (2,015)	$ 881	$ 14,585

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. The Company recognized $0.3 million of stock-based compensation expense within general and administrative expenses related to awards of restricted stock and performance stock units ("PSUs") to its employees and directors during the Successor period August 14, 2018 through September 30, 2018 and $0.8 million during the predecessor period July 1 through August 13, 2018. For the predecessor periods of the three and nine months ended September 30, 2017, the Company recognized $1.7 million and $4.5 million, respectively, of stock-based compensation expense.

During the period July 1, 2018 through August 13, 2018, the Predecessor Company granted 100,226 shares of restricted stock with a grant date fair value of $0.9 million, or $8.73 per share, to its independent directors. The change of control that occurred due to the Jones Contribution resulting in the vesting of all then outstanding restricted stock grants of 904,181 shares.

During the successor period August 14, 2018 through September 30, 2018, the Company granted 422,545 shares of restricted stock with a grant date fair value of $3.7 million, or $8.70 per share, to its employees. The fair value of each restricted share on the date of grant was equal to its market price. Total unrecognized compensation cost related to unvested restricted stock grants of $3.5 million as of September 30, 2018 is expected to be recognized over a period of 2.9 years.

The change of control that occurred due to the Jones Contribution also resulted in the vesting of all then outstanding performance share units at the maximum amount that could be earned, and a total of 1,028,672 shares of common stock were issued to employees.

During the successor period August 14, 2018 through September 30, 2018, the Company granted 335,545 PSUs with a grant date fair value of $4.3 million, or $12.93 per unit, to its employees, all of which were outstanding as of September 30, 2018. The number of shares of common stock to be issued related to the PSUs is based on the Company's stock price performance as compared to its peers which could result in the issuance of anywhere from zero to 671,090 shares of common stock. Total unrecognized compensation cost related to these grants of $4.2 million as of September 30, 2018 is expected to be recognized over a period of 2.9 years.

Revenue Recognition

On January 1, 2018, the Company adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). Comstock adopted this standard using the modified retrospective method of adoption, and it applied the ASU only to contracts that were not completed as of January 1, 2018. Upon adoption, there were no adjustments to the opening balance of equity.

Comstock produces oil and natural gas and reports revenues separately for each of these two primary products in its statements of operations. Revenues are recognized upon the transfer of produced volumes to the Company's customers, who take control of the volumes and receive all the benefits of ownership upon delivery at designated sales points. Payment is reasonably assured upon delivery of production. All sales are subject to contracts that have commercial substance, contain specific pricing terms, and define the enforceable rights and obligations of both parties. These contracts typically provide for cash settlement within 25 days following each production month and are cancellable upon 30 days' notice by either party. Prices for sales of oil and natural gas are generally based upon terms that are common in the oil and gas industry, including index or spot prices, location and quality differentials, as well as market supply and demand conditions. As a result, prices for oil and natural gas routinely fluctuate based on changes in these factors. Each unit of production (barrel of crude oil and thousand cubic feet of natural gas) represents a separate performance obligation under the Company's contracts since each unit has economic benefit on its own and each is priced separately according to the terms of the contracts.

Comstock has elected to exclude all taxes from the measurement of transaction prices, and its revenues are reported net of royalties and exclude revenue interests owned by others because the Company acts as an agent when selling crude oil and natural gas, on behalf of royalty owners and working interest owners. Revenue is recorded in the month of production based on an estimate of the Company's share of volumes produced and prices realized. The Company recognizes any differences between estimates and actual amounts received in the month when payment is received. Historically, differences between estimated revenues and actual revenue received have not been significant. 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 December 31, 2017 or September 30, 2018. Sales of oil and natural gas generally occur at or near the wellhead. When sales of oil and gas occur at locations other than the wellhead, the Company accounts for costs incurred to transport the production to the delivery point as gathering and transportation expenses. The Company has recognized accounts receivable of $61.0 million as of September 30, 2018 from customers for contracts where performance obligations have been satisfied and an unconditional right to consideration exists.

Income Taxes

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. In recording deferred income tax assets, the Company considers whether it is more likely than not that some portion or all of its deferred income tax assets will be realized in the future. The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the periods in which those deferred income tax assets would be deductible. The Company believes that, after considering all the available objective evidence, historical and prospective, with greater weight given to historical evidence, management is not able to determine that it is more likely than not that all of its deferred tax assets will be realized. As a result, the Company established valuation allowances for its deferred tax assets and U.S. federal and state net operating loss carryforwards that are not expected to be utilized due to the uncertainty of generating taxable income prior to the expiration of the carryforward periods.

The following is an analysis of consolidated income tax provision (benefit):

	Three Months ended September 30,			Nine Months ended September 30,		
	Transition Period			Transition Period		
	Successor	Predecessor	Predecessor	Successor	Predecessor	Predecessor
	For the Period from August 14, 2018 through September 30, 2018	For the Period from July 1, 2018 through August 13, 2018	2017	For the Period from August 14, 2018 through September 30, 2018	For the Period from January 1, 2018 through August 13, 2018	2017
	(In thousands)					
Current - State	$57	$ (22)	$ 18	$57	$ 13	$ 115
- Federal	—	—	—	—	—	—
Deferred - State	20	(309)	(87)	20	(1,360)	768
- Federal	3,863	936	—	3,863	2,412	—
	$3,940	$ 605	$ (69)	$3,940	$ 1,065	$ 883

The difference between the Company's effective tax rate and the 21% federal statutory rate in effect in 2018 and the 35% rate in effect in 2017 is caused by valuation allowances on deferred taxes and state taxes. The impact of these items varies based upon the Company's projected full year loss and the jurisdictions that are expected to generate the projected losses.

The difference between the federal statutory rate and the effective tax rate is due to the following:

	Three Months ended September 30,			Nine Months ended September 30,		
	Transition Period			Transition Period		
	Successor	Predecessor	Predecessor	Successor	Predecessor	Predecessor
	For the Period from August 14, 2018 through September 30, 2018	For the Period from July 1, 2018 through August 13, 2018	2017	For the Period from August 14, 2018 through September 30, 2018	For the Period from January 1, 2018 through August 13, 2018	2017
	(In thousands)					
Tax at statutory rate	21.0%	21.0%	35.0%	21.0%	21.0%	35.0%
Tax effect of:						
State income taxes, net of federal benefit	2.0	4.5	3.8	2.0	3.9	4.1
Valuation allowance on deferred tax assets	(0.6)	(21.1)	(37.8)	(0.6)	(24.1)	(39.2)
Nondeductible stock-based compensation	(0.2)	(0.7)	(0.7)	(0.2)	(0.7)	(1.1)
Other	—	(7.4)	—	—	(1.3)	(0.1)
Effective tax rate	22.2%	(3.7)%	0.3%	22.2%	(1.2)%	(1.3)%

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The Tax Cuts and Jobs Act, which was enacted on December 22, 2017, reduced the corporate income tax rate effective January 1, 2018 from 35% to 21%. Among the other significant tax law changes that potentially affect the Company are the elimination of the corporate alternative minimum tax ("AMT"), changes that require operating losses incurred in 2018 and beyond be carried forward indefinitely with no carryback up to 80% of taxable income in a given year, and limitations on the deduction for interest expense incurred in 2018 or later for amounts in excess of 30% of its adjusted taxable income (defined as taxable income before interest and net operating losses). For tax years beginning before January 1, 2022, the adjusted taxable income for these purposes is also adjusted to exclude the impact of depreciation, depletion and amortization. The Tax Cuts and Jobs Act preserved deductibility of intangible drilling costs for federal income tax purposes, which allows the Company to deduct a portion of drilling costs in the year incurred and minimizes current taxes payable in periods of taxable income. At September 30, 2018, the Company has not completed its accounting for the tax effects of enactment of the Tax Cuts and Jobs Act; however, it has made reasonable estimates of the effects on its existing deferred tax balances. The Company has remeasured certain deferred federal tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21%. The provisional amount recognized at December 31, 2017 related to the remeasurement of its deferred federal tax balance was $140.4 million, which was subject to a valuation allowance. The Tax Cuts and Jobs Act also repealed the AMT for tax years beginning on or after January 1, 2018 and provides that existing AMT credit carryforwards can be utilized to offset federal taxes for any taxable year. In addition, 50% of any unused AMT credit carryforwards can be refunded during tax years 2018 through 2020. The Company reclassified $19.1 million to a non-current receivable at December 31, 2017 representing the amount of AMT that is now refundable through 2021. The Company is still analyzing certain aspects of the Tax Cuts and Jobs Act, and refining its calculations, which could potentially affect the measurement of those balances or potentially give rise to new deferred tax amounts. Comstock's estimates may also be affected in the future as the Company gains a more thorough understanding of the Tax Cuts and Jobs Act, and how the individual states are implementing this new law.

The shares of common stock issued as a result of the Jones Transaction triggered an ownership change under Section 382 of the Internal Revenue Code. As a result, Comstock's ability to use net operating losses ("NOLs") to reduce taxable income is generally limited to an annual amount based on the fair market value of its stock immediately prior to the ownership change multiplied by the long-term tax-exempt interest rate. The Company's NOLs are estimated to be limited to $3.3 million a year as a result of this limitation. In addition to this limitation, IRC Section 382 provides that a corporation with a net unrealized built-in gain immediately before an ownership change may increase its limitation by the amount of recognized built-in gain recognized during a recognition period, which is generally the five-year period immediately following an ownership change. Based on the fair market value of the Company's common stock immediately prior to the ownership change, Comstock believes that it has a net unrealized built-in gain which will increase the Section 382 limitation during the five-year recognition period.

NOLs that exceed the Section 382 limitation in any year continue to be allowed as carry forwards until they expire and can be used to offset taxable income for years within the carryover period subject to the limitation in each year. NOLs incurred prior to 2018 generally have a 20-year life until they expire. NOLs generated in 2018 and after would be carried forward indefinitely. Comstock's use of new NOLs arising after the date of an ownership change would not be affected by the 382 limitation. If the Company does not generate a sufficient level of taxable income prior to the expiration of the pre-2018 NOL carry forward periods, then it will lose the ability to apply those NOLs as offsets to future taxable income.

The Company's federal income tax returns for the years subsequent to December 31, 2014 remain subject to examination. The Company's income tax returns in major state income tax jurisdictions remain subject to examination for various periods subsequent to December 31, 2012. 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 or has held certain financial assets and liabilities that are required to be measured at fair value. These include cash and cash equivalents held in bank accounts and derivative financial instruments in the form of oil and 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 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.

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 cash equivalents valuation is based on Level 1 measurements. The Company's oil and natural gas price swap agreements and its natural gas price collars were not traded on a public exchange, and their value is 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, is categorized as a Level 2 measurement. There are no financial assets or liabilities accounted for at fair value as of September 30, 2018 that are a Level 3 measurement.

At September 30, 2018, the Company had a liability of $2.8 million recorded for the fair value of its oil and natural gas swaps and collars. At December 31, 2017, the Company had assets recorded for the fair value of its natural gas price swap agreements of $1.3 million. There were no offsetting swap positions in 2018 or 2017. The change in fair value of these natural gas swaps and collars was recognized as a gain or loss and included as a component of other income (expense).

As of September 30, 2018, the Company's fixed rate debt had a carrying value of $816.3 million and a fair value of $850.0 million. The fair value of the Company's fixed rate debt was based on quoted prices as of September 30, 2018, a Level 2 measurement. The fair value of the floating rate debt outstanding approximated its carrying value, a Level 2 measurement.

Earnings Per Share

Unvested share-based payment awards containing nonforfeitable rights to dividends are considered to be participating securities and included in the computation of basic and diluted earnings per share pursuant to the two-class method. PSUs represent the right to receive a number of shares of the Company's common stock that may range from zero to up to two times the number of PSUs granted on the award date based on the achievement of certain performance measures during a performance period. The number of potentially dilutive shares related to PSUs is based on the number of shares, if any, which would be issuable at the end of the respective period, assuming that date was the end of the contingency period. The treasury stock method is used to measure the dilutive effect of PSUs. The shares that would have been issuable upon exercise of the conversion rights contains in the Predecessor Company's convertible debt for each period are based on the if-converted method for computing potentially dilutive shares of common stock that could be issued upon conversion. None of the Company's participating securities participate in losses and as such are excluded from the computation of basic earnings per share during periods of net losses.

Basic and diluted income (loss) per share were determined as follows:

	Successor For the Period from August 14, 2018 through September 30, 2018		
	Income	Shares	Per Share
	(In thousands, except per share amounts)		
Net income attributable to common stock	$13,823		
Income allocable to unvested restricted shares	(51)		
Basic income attributable to common stock	13,772	105,448	$0.13