SWIFT ENERGY CO
Form 10-Q
November 01, 2012

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

FORM 10-Q

(X) Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2012
Commission File Number 1-8754
SWIFT ENERGY COMPANY
(Exact Name of Registrant as Specified in Its Charter)

Texas	20-3940661
(State of Incorporation)	(I.R.S. Employer Identification No.)

16825 Northchase Drive, Suite 400
Houston, Texas 77060
(281) 874-2700
(Address and telephone number of principal executive offices)
Securities registered pursuant to Section 12(b) of the Act:

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes	þ	No	o

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	þ	No	o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

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

Yes	o	No	þ

Indicate the number of shares outstanding of each of the Issuer’s classes
of common stock, as of the latest practicable date.

Common Stock ($.01 Par Value) (Class of Stock)	42,923,371 Shares (Outstanding at October 31, 2012)

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SWIFT ENERGY COMPANY

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012
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Condensed Consolidated Balance Sheets
Swift Energy Company and Subsidiaries (in thousands, except share amounts)

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$1,650	$251,696
Accounts receivable	49,994	64,392
Deferred tax asset	4,864	6,603
Other current assets	5,873	5,460
Total Current Assets	62,381	328,151
Property and Equipment:		
Property and Equipment	5,046,268	4,466,845
Less – Accumulated depreciation, depletion, and amortization	(2,781,965)	(2,599,079)
Property and Equipment, Net	2,264,303	1,867,766
Other Long-Term Assets	14,803	16,552
Total Assets	$2,341,487	$2,212,469
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and accrued liabilities	$99,606	$95,966
Accrued capital costs	82,187	98,844
Accrued interest	12,016	12,459
Undistributed oil and gas revenues	2,722	4,525
Total Current Liabilities	196,531	211,794
Long-Term Debt	822,721	719,775
Deferred Tax Liabilities	212,876	206,567
Asset Retirement Obligation	77,204	67,115
Other Long-Term Liabilities	10,795	10,709
Commitments and Contingencies	—	—
Stockholders' Equity:		
Preferred stock, $.01 par value, 5,000,000 shares authorized, none outstanding	—	—
Common stock, $.01 par value, 150,000,000 shares authorized, 43,431,240 and 42,969,546 shares issued, and 42,912,453 and 42,485,075 shares outstanding, respectively	434	430
Additional paid-in capital	743,677	726,956
Treasury stock held, at cost, 518,787, and 484,471 shares, respectively	(13,831)	(12,350)
Retained earnings	291,193	281,473
Accumulated other comprehensive loss, net of income tax	(113)	—
Total Stockholders' Equity	1,021,360	996,509
Total Liabilities and Stockholders' Equity	$2,341,487	$2,212,469

See accompanying Notes to Condensed Consolidated Financial Statements.

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Condensed Consolidated Statements of Operations (Unaudited)
Swift Energy Company and Subsidiaries (in thousands, except per-share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues:				
Oil and gas sales	$127,946	$143,123	$396,068	$446,537
Price-risk management and other, net	804	(591)	3,317	(2,499)
Total Revenues	128,750	142,532	399,385	444,038
Costs and Expenses:				
General and administrative, net	11,952	11,378	36,025	32,687
Depreciation, depletion, and amortization	58,987	54,404	181,638	163,141
Accretion of asset retirement obligation	1,191	1,183	3,465	3,482
Lease operating cost	26,634	26,206	85,330	78,296
Severance and other taxes	10,680	13,527	35,840	39,223
Interest expense, net	13,762	8,439	40,546	25,449
Total Costs and Expenses	123,206	115,137	382,844	342,278
Income from Continuing Operations Before Income Taxes	5,544	27,395	16,541	101,760
Provision for Income Taxes	2,422	10,388	6,821	37,822
Income from Continuing Operations	3,122	17,007	9,720	63,938
Income (loss) from Discontinued Operations, net of taxes	—	(31)	—	14,247
Net Income	$3,122	$16,976	$9,720	$78,185
Per Share Amounts-				
Basic: Income from Continuing Operations	$0.07	$0.39	$0.22	$1.48
Income (loss) from Discontinued Operations, net of taxes	—	——	—	0.33
Net Income	$0.07	$0.39	$0.22	$1.81
Diluted: Income from Continuing Operations	$0.07	$0.39	$0.22	$1.47
Income (loss) from Discontinued Operations, net of taxes	—	—	—	0.33
Net Income	$0.07	$0.39	$0.22	$1.80
Weighted Average Shares Outstanding - Basic	42,901	42,470	42,812	42,365

See accompanying Notes to Condensed Consolidated Financial Statements.

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Condensed Consolidated Statements of Comprehensive Income (Unaudited)
Swift Energy Company and Subsidiaries (in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net Income:	$3,122	$16,976	$9,720	$78,185
Other Comprehensive Income:				
Unrealized gains (losses) related to price risk management transactions, before taxes	66	(72)	1,237	(405)
Provision (benefit) for income taxes	24	(27)	450	(148)
Unrealized gains (losses) related to price risk management transactions, net of taxes	42	(45)	787	(257)
Less: reclassification of (gains) losses on price risk management transactions to net income, before taxes	(244)	(260)	(1,415)	623
(Provision) benefit for income taxes	(89)	(95)	(515)	229
Reclassification of (gains) losses on price risk management transactions to net income, net of taxes	(155)	(165)	(900)	394
Other comprehensive income (loss), before income taxes	(178)	(332)	(178)	218
Provision (benefit) for income taxes	(65)	(122)	(65)	80
Other comprehensive income (loss), net of taxes	(113)	(210)	(113)	138
Comprehensive Income	$3,009	$16,766	$9,607	$78,323

See accompanying Notes to Condensed Consolidated Financial Statements.

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Condensed Consolidated Statements of Stockholders' Equity
Swift Energy Company and Subsidiaries (in thousands, except share amounts)

	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2010	$424	$706,857	$(9,778)	$182,652	$(138)	$880,017
Stock issued for benefit plans (37,068 shares)	—	791	821	—	—	1,612
Stock options exercised (130,902 shares)	1	1,150	—	—	—	1,151
Purchase of treasury shares (80,014 shares)	—	—	(3,393)	—	—	(3,393)
Tax benefits from stock compensation	—	333	—	—	—	333
Employee stock purchase plan (49,089 shares)	1	999	—	—	—	1,000
Issuance of restricted stock (348,972 shares)	4	(4)	—	—	—	—
Amortization of stock compensation	—	16,830	—	—	—	16,830
Net Income	—	—	—	98,821	—	98,821
Other comprehensive income	—	—	—	—	138	138
Balance, December 31, 2011	$430	$726,956	$(12,350)	$281,473	$—	$996,509
Stock issued for benefit plans (50,987 shares) (1)	—	354	1,300	—	—	1,654
Stock options exercised (49,605 shares) (1)	—	523	—	—	—	523
Purchase of treasury shares (85,302 shares) (1)	—	—	(2,781)	—	—	(2,781)
Tax benefits from stock compensation (1)	—	126	—	—	—	126
Employee stock purchase plan (42,624 shares) (1)	—	1,076	—	—	—	1,076
Issuance of restricted stock (369,465 shares) (1)	4	(4)	—	—	—	—
Amortization of share-based compensation (1)	—	14,646	—	—	—	14,646
Net Income (1)	—	—	—	9,720	—	9,720
Other comprehensive loss (1)	—	—	—	—	(113)	(113)
Balance, September 30, 2012 (1)	$434	$743,677	$(13,831)	$291,193	$(113)	$1,021,360

(1) Unaudited

See accompanying Notes to Condensed Consolidated Financial Statements.

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Condensed Consolidated Statements of Cash Flows (Unaudited)
Swift Energy Company and Subsidiaries (in thousands)

	Nine Months Ended September 30,	
	2012	2011
Cash Flows from Operating Activities:		
Net income	$9,720	$78,185
Less gain from discontinued operations, net of taxes	—	(14,247)
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation, depletion, and amortization	181,638	163,141
Accretion of asset retirement obligation	3,465	3,482
Deferred income taxes	8,239	36,332
Stock-based compensation expense	10,562	9,281
Other	(583)	(1,410)
Change in assets and liabilities-		
Decrease in accounts receivable	14,385	6,694
Increase (decrease) in accounts payable and accrued liabilities	(3,051)	8,077
Decrease in income taxes payable	(248)	(234)
Decrease in accrued interest	(443)	(787)
Cash provided by operating activities – continuing operations	223,684	288,514
Cash provided by operating activities – discontinued operations	—	5
Net Cash Provided by Operating Activities	223,684	288,519
Cash Flows from Investing Activities:		
Additions to property and equipment	(575,711)	(368,754)
Proceeds from the sale of property and equipment	523	6,084
Cash used in investing activities – continuing operations	(575,188)	(362,670)
Cash provided by investing activities – discontinued operations	—	5,000
Net Cash Used in Investing Activities	(575,188)	(357,670)
Cash Flows from Financing Activities:		
Net proceeds from bank borrowings	102,640	—
Net proceeds from issuances of common stock	1,599	2,102
Purchase of treasury shares	(2,781)	(3,319)
Cash provided by (used in) financing activities – continuing operations	101,458	(1,217)
Cash provided by financing activities – discontinued operations	—	—
Net Cash Provided By (Used in) Financing Activities	101,458	(1,217)
Net Decrease in Cash and Cash Equivalents	(250,046)	(70,368)
Cash and Cash Equivalents at Beginning of Period	251,696	86,367
Cash and Cash Equivalents at End of Period	$1,650	$15,999
Supplemental Disclosures of Cash Flows Information:		
Cash paid during period for interest, net of amounts capitalized	$39,175	$24,693
Cash paid during period for income taxes	$248	$1,770

See accompanying Notes to Condensed Consolidated Financial Statements.

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Notes to Condensed Consolidated Financial Statements
Swift Energy Company and Subsidiaries

(1) General Information

The condensed consolidated financial statements included herein have been prepared by Swift Energy Company (“Swift Energy,” the “Company,” or “we”) and reflect necessary adjustments, all of which were of a recurring nature unless otherwise disclosed herein, and are in the opinion of our management necessary for a fair presentation. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted pursuant to the rules and regulations of the Securities and Exchange Commission. We believe that the disclosures presented are adequate to allow the information presented not to be misleading. The condensed consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 as filed with the Securities and Exchange Commission. The accompanying condensed consolidated financial statements, for the nine months ended September 30, 2012, include a reduction of approximately $0.9 million to oil and gas revenue and approximately $0.8 million of additional severance tax expense. Both of these items related to prior year activity and were not deemed material with respect to either the results of the prior year or the anticipated results and the trend of earnings for fiscal year 2012.

(2) Summary of Significant Accounting Policies

Principles of Consolidation. The accompanying condensed consolidated financial statements include the accounts of Swift Energy and its wholly owned subsidiaries, which are engaged in the exploration, development, acquisition, and operation of oil and gas properties, with a focus on inland waters and onshore oil and natural gas reserves in Louisiana and Texas. Our undivided interests in oil and gas properties are accounted for using the proportionate consolidation method, whereby our proportionate share of each entity’s assets, liabilities, revenues, and expenses are included in the appropriate classifications in the accompanying condensed consolidated financial statements. Intercompany balances and transactions have been eliminated in preparing the accompanying condensed consolidated financial statements.

Discontinued Operations. Unless otherwise indicated, information presented in the notes to the condensed consolidated financial statements relates only to Swift Energy’s continuing operations. Information related to discontinued operations is included in Note 6 and in some instances, where appropriate, is included as a separate disclosure within the individual footnotes.

Subsequent Events. In the fourth quarter of 2012, we issued an additional $150.0 million of 7.875% senior notes due on March 1, 2022 and used the proceeds to pay down the outstanding borrowings under our credit facility. We also extended the maturity on our credit facility through November 1, 2017 and increased the borrowing base and commitment amount. See footnote 5 for further details of these subsequent events.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”) requires us to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and the reported amounts of certain revenues and expenses during each reporting period. We believe our estimates and assumptions are reasonable; however, such estimates and assumptions are subject to a number of risks and uncertainties that may cause actual results to differ materially from such estimates. Significant estimates and assumptions underlying these financial statements include:

- the estimated quantities of proved oil and natural gas reserves used to compute depletion of oil and natural gas properties and the related present value of estimated future net cash flows there-from,
- estimates related to the collectability of accounts receivable and the credit worthiness of our customers,

- estimates of the counterparty bank risk related to letters of credit that our customers may have issued on our behalf,
- estimates of future costs to develop and produce reserves,
- accruals related to oil and gas sales, capital expenditures and lease operating expenses,
- estimates of insurance recoveries related to property damage, and the solvency of insurance providers,
- estimates in the calculation of share-based compensation expense,
- estimates of our ownership in properties prior to final division of interest determination,
- the estimated future cost and timing of asset retirement obligations,
- estimates made in our income tax calculations, and
- estimates in the calculation of the fair value of hedging assets.

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While we are not aware of any material revisions to any of our estimates, there will likely be future revisions to our estimates resulting from matters such as new accounting pronouncements, changes in ownership interests, payouts, joint venture audits, re-allocations by purchasers or pipelines, or other corrections and adjustments common in the oil and gas industry, many of which require retroactive application. These types of adjustments cannot be currently estimated and will be recorded in the period during which the adjustment occurs.

Property and Equipment. We follow the "full-cost" method of accounting for oil and natural gas property and equipment costs. Under this method of accounting, all productive and nonproductive costs incurred in the exploration, development, and acquisition of oil and natural gas reserves are capitalized. Such costs may be incurred both prior to and after the acquisition of a property and include lease acquisitions, geological and geophysical services, drilling, completion, and equipment. Internal costs incurred that are directly identified with exploration, development, and acquisition activities undertaken by us for our own account, and which are not related to production, general corporate overhead, or similar activities, are also capitalized. For the nine months ended September 30, 2012 and 2011, such internal costs capitalized totaled $23.9 million and $21.9 million, respectively. Interest costs are also capitalized to unproved oil and natural gas properties. For the nine months ended September 30, 2012 and 2011, capitalized interest on unproved properties totaled $6.0 million and $5.7 million, respectively. Interest not capitalized and general and administrative costs related to production and general corporate overhead are expensed as incurred.

The "Property and Equipment" balances on the accompanying condensed consolidated balance sheets are summarized for presentation purposes. The following is a detailed breakout of our "Property and Equipment" balances.

(in thousands)	September 30, 2012	December 31, 2011
Property and Equipment		
Proved oil and gas properties	$4,913,556	$4,343,867
Unproved oil and gas properties	91,415	84,146
Furniture, fixtures, and other equipment	41,297	38,832
Less – Accumulated depreciation, depletion, and amortization	(2,781,965)	(2,599,079)
Property and Equipment, Net	$2,264,303	$1,867,766

No gains or losses are recognized upon the sale or disposition of oil and natural gas properties, except in transactions involving a significant amount of reserves or where the proceeds from the sale of oil and natural gas properties would significantly alter the relationship between capitalized costs and proved reserves of oil and natural gas attributable to a cost center. Internal costs associated with selling properties are expensed as incurred.

Future development costs are estimated property-by-property based on current economic conditions and are amortized to expense as our capitalized oil and gas property costs are amortized.

We compute the provision for depreciation, depletion, and amortization ("DD&A") of oil and natural gas properties using the unit-of-production method. Under this method, we compute the provision by multiplying the total unamortized costs of oil and gas properties—including future development costs, gas processing facilities, and both capitalized asset retirement obligations and undiscounted abandonment costs of wells to be drilled, net of salvage values, but excluding costs of unproved properties—by an overall rate determined by dividing the physical units of oil and natural gas produced during the period by the total estimated units of proved oil and natural gas reserves at the beginning of the period. This calculation is done on a country-by-country basis, and the period over which we will amortize these properties is dependent on our production from these properties in future years. Furniture, fixtures, and other equipment are recorded at cost and are depreciated by the straight-line method at rates based on the estimated useful lives of the property, which range between 2 and 20 years. Repairs and maintenance are charged to expense as incurred. Renewals and betterments are capitalized.

Geological and geophysical (“G&G”) costs incurred on developed properties are recorded in “Proved properties” and therefore subject to amortization. G&G costs incurred that are directly associated with specific unproved properties are capitalized in “Unproved properties” and evaluated as part of the total capitalized costs associated with a prospect. The cost of unproved properties not being amortized is assessed quarterly, on a property-by-property basis, to determine whether such properties have been impaired. In determining whether such costs should be impaired, we evaluate current drilling results, lease expiration dates, current oil and gas industry conditions, international economic conditions, capital availability, and available geological and geophysical information. Any impairment assessed is added to the cost of proved properties being amortized.

Full-Cost Ceiling Test. At the end of each quarterly reporting period, the unamortized cost of oil and natural gas properties (including natural gas processing facilities, capitalized asset retirement obligations, net of related salvage values and deferred income taxes, and excluding the recognized asset retirement obligation liability) is limited to the sum of the estimated future net revenues from proved properties (excluding cash outflows from recognized asset retirement obligations, including future development and abandonment costs of wells to be drilled, using the preceding 12-months' average price based on closing prices on the first day of each month, adjusted for price differentials and the effects of hedging, discounted at 10% , and the lower of cost or fair value of unproved properties) adjusted for related income tax effects ("Ceiling Test"). This calculation is done on a country-by-country basis.

The calculation of the Ceiling Test and provision for DD&A is based on estimates of proved reserves. There are numerous uncertainties inherent in estimating quantities of proved reserves and in projecting the future rates of production, timing, and plan of development. The accuracy of any reserves estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. Results of drilling, testing, and production subsequent to the date of the estimate may justify revision of such estimates. Accordingly, reserves estimates are often different from the quantities of oil and natural gas that are ultimately recovered.

Given the volatility of oil and natural gas prices, it is reasonably possible that our estimate of discounted future net cash flows from proved oil and natural gas reserves could continue to change in the near term. If oil and natural gas prices decline from our prices used in the Ceiling Test, it is reasonably possible that non-cash write-downs of oil and natural gas properties would occur in the future. If we have significant declines in our oil and natural gas reserves volumes, which also reduce our estimate of discounted future net cash flows from proved oil and natural gas reserves, non-cash write-downs of our oil and natural gas properties would occur in the future. We cannot control and cannot predict what future prices for oil and natural gas will be, thus we cannot estimate the amount or timing of any potential future non-cash write-down of our oil and natural gas properties if a decrease in oil and/or natural gas prices were to occur.

Revenue Recognition. Oil and gas revenues are recognized when production is sold to a purchaser at a fixed or determinable price, when delivery has occurred and title has transferred, and if collectability of the revenue is probable. Swift Energy uses the entitlement method of accounting in which we recognize our ownership interest in production as revenue. If our sales exceed our ownership share of production, the natural gas balancing payables are reported in "Accounts payable and accrued liabilities" on the accompanying condensed consolidated balance sheets. Natural gas balancing receivables are reported in "Other current assets" on the accompanying condensed consolidated balance sheets when our ownership share of production exceeds sales. As of September 30, 2012 and December 31, 2011, we did not have any material natural gas imbalances.

Reclassification of Prior Period Balances. Certain reclassifications have been made to prior period amounts to conform to the current-year presentation.

Accounts Receivable. We assess the collectability of accounts receivable, and based on our judgment, we accrue a reserve when we believe a receivable may not be collected. At September 30, 2012 and December 31, 2011, we had an allowance for doubtful accounts of approximately $0.1 million. The allowance for doubtful accounts has been deducted from the total "Accounts receivable" balance on the accompanying condensed consolidated balance sheets.

At September 30, 2012, our "Accounts receivable" balance included $39.5 million for oil and gas sales, $3.5 million for joint interest owners and $7.0 million for other receivables. At December 31, 2011, our "Accounts receivable" balance included $54.7 million for oil and gas sales, $4.2 million for joint interest owners and $5.6 million for other receivables.

Debt Issuance Costs. Legal fees, accounting fees, underwriting fees, printing costs, and other direct expenses associated with extensions of our bank credit facility and public debt offerings were capitalized and are amortized on an effective interest basis over the life of each of the respective note offerings and credit facility.

The 7.125% senior notes due in 2017 mature on June 1, 2017, and the balance of their issuance costs at September 30, 2012, was $2.3 million, net of accumulated amortization of $1.9 million. The 8.875% senior notes due in 2020 mature on January 15, 2020, and the balance of their issuance costs at September 30, 2012, was $4.1 million, net of accumulated amortization of $1.0 million. The 7.875% senior notes due in 2022 mature on March 1, 2022, and the balance of their issuance costs at September 30, 2012, was $4.5 million, net of accumulated amortization of $0.3 million. The balance of revolving credit facility issuance costs at September 30, 2012, was $2.9 million, net of accumulated amortization of $4.6 million.

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Price-Risk Management Activities. The Company follows FASB ASC 815-10, which requires that changes in the derivative's fair value are recognized currently in earnings unless specific hedge accounting criteria are met. The guidance also establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) is recorded in the condensed consolidated balance sheets as either an asset or a liability measured at its fair value. Hedge accounting for a qualifying hedge allows the gains and losses on derivatives to offset related results on the hedged item in the statement of operations and requires that a company formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. Changes in the fair value of derivatives that do not meet the criteria for hedge accounting, and the ineffective portion of the hedge, are recognized currently in income.

We have a price-risk management policy to use derivative instruments to protect against declines in oil and natural gas prices, mainly through the purchase of price floors and collars. When we entered into the transactions discussed below, they were designated as a hedge of the variability in cash flows associated with the forecasted sale of oil and natural gas production. Changes in the fair value of a hedge that is highly effective and is designated and documented and qualifies as a cash flow hedge, to the extent that the hedge is effective, are recorded in "Accumulated other comprehensive income, net of income tax." When the hedged transactions are recorded upon the actual sale of the oil and natural gas, these gains or losses are reclassified from "Accumulated other comprehensive income, net of income tax" on the accompanying condensed consolidated balance sheets and are recorded in "Price-risk management and other, net" on the accompanying condensed consolidated statements of operations. The fair values of our derivatives are computed using the Black-Scholes-Merton option pricing model and are periodically verified against quotes from brokers.

During the three months ended September 30, 2012 and 2011, we recognized a net gain of $0.2 million and $0.3 million, respectively, relating to our derivative activities. During the nine months ended September 30, 2012 and 2011, we recognized a net gain of $2.5 million and a net loss of $0.8 million, respectively, relating to our derivative activities. This activity is recorded in "Price-risk management and other, net" on the accompanying condensed consolidated statements of operations. Had these amounts been recognized in the oil and gas sales account they would not have materially changed our per unit sales prices received. The ineffectiveness reported in "Price-risk management and other, net" for the three and nine month periods ended September 30, 2012 and 2011, was not material.

At September 30, 2012, the Company had $0.1 million of derivative losses recorded in "Accumulated other comprehensive income, net of income tax" on the accompanying condensed consolidated balance sheet. At December 31, 2011, the Company had no derivative gains or losses recorded. At September 30, 2012, the Company did not have any significant fair value recorded for derivative instruments while at December 31, 2011, we recognized $0.1 million of fair value on the accompanying condensed consolidated balance sheet in "Other current assets."

At September 30, 2012, we had natural gas price floors in effect that cover natural gas production of 1,660,000 MMBtu from October 2012 through November 2012 with strike prices ranging from of $2.92 per MMBtu to $2.97 per MMBtu.

Supervision Fees. Consistent with industry practice, we charge a supervision fee to the wells we operate including our wells in which we own up to a 100% working interest. Supervision fees are recorded as a reduction to "General and administrative, net." Our supervision fees are based on COPAS guidelines. The amount of supervision fees charged for the first nine months of 2012 and 2011 did not exceed our actual costs incurred. The total amount of supervision fees charged to the wells we operated was $8.6 million and $10.0 million in the first nine months of 2012 and 2011, respectively.

Inventories. Inventories consist primarily of tubulars and other equipment and supplies that we expect to place in service in production operations. Inventories carried at cost (weighted average method) are included in "Other current assets" on the accompanying condensed consolidated balance sheets totaling $2.7 million at September 30, 2012 and $3.6 million at December 31, 2011.

In the nine months ended September 30, 2012 and 2011, we recorded a charge of less than $0.1 million and $1.6 million, respectively, related to inventory obsolescence in "Price-risk management and other, net" on the accompanying condensed statement of operations.

Income Taxes. Under guidance contained in FASB ASC 740-10, deferred taxes are determined based on the estimated future tax effects of differences between the financial statement and tax basis of assets and liabilities, given the provisions of the enacted tax laws.

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We follow the recognition and disclosure provisions under guidance contained in FASB ASC 740-10-25. Under this guidance, tax positions are evaluated for recognition using a more-likely-than-not threshold, and those tax positions requiring recognition are measured as the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. The Company's deferred tax liability for uncertain tax positions of $1.0 million is included in "Other Long-Term Liabilities" on the accompanying condensed consolidated balance sheets. If recognized, these tax benefits would fully impact our effective tax rate. This benefit is likely to be recognized within the next 12 months due to the lapse of the applicable statute of limitations.

Our policy is to record interest and penalties relating to income taxes in income tax expense. As of September 30, 2012, we did not have any amount accrued for interest and penalties on uncertain tax positions.

Our U.S. Federal income tax returns for 2002 forward (except for 2008 which was closed through the IRS audit process), our Louisiana income tax returns from 1998 forward, our New Zealand income tax returns after 2005, and our Texas franchise tax returns after 2006 remain subject to examination by the taxing authorities. There are no material unresolved items related to income tax returns previously audited by these taxing authorities. No other state income tax returns are significant to our financial position.

Accounts Payable and Accrued Liabilities. The “Accounts payable and accrued liabilities” balances on the accompanying condensed consolidated balance sheets are summarized below for presentation purposes. The following is a detailed breakout of certain items within “Accounts payable and accrued liabilities” in the corresponding periods (in thousands):

	September 30, 2012	December 31, 2011
Trade accounts payable (1)	$60,785	$42,080
Accrued operating expenses	11,328	15,833
Accrued payroll costs	10,984	14,345
Asset retirement obligation – current portion	6,088	9,279
Accrued taxes	8,618	7,604
Other payables	1,803	6,825
Total accounts payable and accrued liabilities	$99,606	$95,966

(1) Included in “trade accounts payable” are liabilities of approximately $28.3 million and $18.7 million at September 30, 2012 and December 31, 2011, respectively, for outstanding checks.

Cash and Cash Equivalents. We consider all highly liquid instruments with an initial maturity of three months or less to be cash equivalents.

Restricted Cash. These balances primarily include amounts held in escrow accounts to satisfy domestic plugging and abandonment obligations. As of September 30, 2012 and December 31, 2011, these assets were approximately $1.0 million and $1.3 million, respectively. These amounts are restricted as to their current use, and will be released when we have satisfied all plugging and abandonment obligations in certain fields. Restricted cash balances are reported in “Other long-term assets” on the accompanying condensed consolidated balance sheets.

Accumulated Other Comprehensive Loss, Net of Income Tax. We follow the guidance contained in FASB ASC 220-10, which establishes standards for reporting comprehensive income. In addition to net income, comprehensive income or loss includes all changes to equity during a period, except those resulting from investments and distributions to the owners of the Company. At September 30, 2012, the Company had $0.1 million in losses recorded in “Accumulated other comprehensive income, net of income tax” on the accompanying condensed consolidated balance sheet. The components of accumulated other comprehensive income and related tax effects for 2012 were as follows (in thousands):

	Gross Value	Tax Effect	Net of Tax Value
Other comprehensive loss at December 31, 2011	$—	$—	$—
Change in fair value of cash flow hedges	1,237	450	787
Effect of cash flow hedges settled during the period	(1,415)	(515)	(900)
Other comprehensive loss at September 30, 2012	$(178)	$(65)	$(113)

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Asset Retirement Obligation. We record these obligations in accordance with the guidance contained in FASB ASC 410-20. This guidance requires entities to record the fair value of a liability for legal obligations associated with the retirement obligations of tangible long-lived assets in the period in which it is incurred. When the liability is initially recorded, the carrying amount of the related long-lived asset is increased. The liability is discounted from the expected date of abandonment. Over time, accretion of the liability is recognized each period, and the capitalized cost is depreciated on a unit-of-production basis over the estimated oil and natural gas reserves of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement which is included in the “Property and equipment” balance on our accompanying condensed consolidated balance sheets. This guidance requires us to record a liability for the fair value of our dismantlement and abandonment costs, excluding salvage values.

The following provides a roll-forward of our asset retirement obligation (in thousands):

	2012
Asset Retirement Obligation recorded as of January 1	$ 76,393
Accretion expense	3,465
Liabilities incurred for new wells and facilities construction	1,148
Reductions due to abandoned wells	(1,692)
Revisions in estimates	3,978
Asset Retirement Obligation as of September 30	$ 83,292

At September 30, 2012, approximately $6.1 million of our asset retirement obligation was classified as a current liability in “Accounts payable and accrued liabilities” on the accompanying condensed consolidated balance sheets.

New Accounting Pronouncements. In June 2011, the FASB issued ASU No. 2011-5, which changes the required presentation of other comprehensive income. Under the new guidance, entities will be required to present net income and other comprehensive income, along with the components of net income and other comprehensive income, in either one continuous statement of comprehensive income or in two separate but consecutive statements of net income and comprehensive income. The accounting standards update eliminates the option of presenting the components of other comprehensive income within the statement of changes in stockholders’ equity. We adopted this guidance for the period ending March 31, 2012, which can be seen in our Condensed Consolidated Statements of Comprehensive Income.

(3) Share-Based Compensation

We have various types of share-based compensation plans. Refer to Note 6 of our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, for additional information related to these share-based compensation plans.

We follow guidance contained in FASB ASC 718 to account for share-based compensation.

We receive a tax deduction for certain stock option exercises during the period the options are exercised, generally for the excess of the market value on the exercise date over the exercise price of the options. We receive an additional tax deduction when restricted stock vests at a higher value than the value used to recognize compensation expense at the date of grant. In accordance with guidance contained in FASB ASC 718, we are required to report excess tax benefits from the award of equity instruments as financing cash flows. For the nine months ended September 30, 2012 and 2011, we did not recognize any excess tax benefit or shortfall.

Net cash proceeds from the exercise of stock options were $0.5 million and $1.1 million for the nine months ended September 30, 2012 and 2011, respectively. The actual income tax benefit from stock option exercises was $0.3

million and $1.1 million for the nine months ended September 30, 2012 and 2011, respectively.

Share-based compensation expense for both stock options and restricted stock issued to both employees and non-employees, which was recorded in “General and administrative, net” in the accompanying condensed consolidated statements of operations, was $3.2 million for the three months ended September 30, 2012 and 2011, respectively and was $9.9 million and $8.8 million for the nine months ended September 30, 2012 and 2011, respectively. Share-based compensation recorded in lease operating cost was $0.1 million for the three months ended September 30, 2012 and 2011 and was $0.3 million and $0.2 million for the nine months ended September 30, 2012 and 2011. We also capitalized $1.2 million and $1.1 million of share-based compensation for the three months ended September 30, 2012 and 2011, respectively and capitalized $4.1 million and $3.1 million of share-based

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compensation for the nine months ended September 30, 2012 and 2011, respectively. We view all awards of stock compensation as a single award with an expected life equal to the average expected life of component awards and amortize the award on a straight-line basis over the life of the award.

Stock Options

We use the Black-Scholes-Merton option pricing model to estimate the fair value of stock option awards with the following weighted-average assumptions for options issued during the indicated periods:

	Nine Months Ended September 30,	
	2012	2011
Dividend yield	0%	0%
Expected volatility	61.2%	58.8%
Risk-free interest rate	0.8%	1.9%
Expected life of options (in years)	4.3	3.8
Weighted-average grant-date fair value	$15.71	$19.17

The expected term for grants issued considers all relevant factors including historical and expected future employee exercise behavior. We have analyzed historical volatility, and based on an analysis of all relevant factors, we have used a 5.5 year look-back period to estimate expected volatility of our 2012 and 2011 stock option grants.

At September 30, 2012, we had $4.2 million of unrecognized compensation cost related to stock options, which is expected to be recognized over a weighted-average period of 1.0 year. The following table represents stock option activity for the nine months ended September 30, 2012:

	Shares	Wtd. Avg. Exercise Price
Options outstanding, beginning of period	1,375,281	$ 32.46
Options granted	336,092	$ 32.39
Options canceled	(32,610)	$ 41.19
Options exercised	(70,297)	$ 15.92
Options outstanding, end of period	1,608,466	$ 32.97
Options exercisable, end of period	1,013,829	$ 32.16

The aggregate intrinsic value and weighted average remaining contract life of options outstanding and exercisable at September 30, 2012 was $1.7 million and 6.1 years and $1.7 million and 4.8 years, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2012 was $0.8 million.

Restricted Stock

The plans, as described in Note 6 of our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, allow for the issuance of restricted stock awards that may not be sold or otherwise transferred until certain restrictions have lapsed. The unrecognized compensation cost related to these awards is expected to be expensed over the period the restrictions lapse (generally one to three years).

The compensation expense for these awards was determined based on the closing market price of our stock at the date of grant applied to the total number of shares that were anticipated to fully vest. As of September 30, 2012, we had unrecognized compensation expense of $19.2 million related to restricted stock awards which is expected to be recognized over a weighted-average period of 1.2 years. The grant date fair value of shares vested during the nine months ended September 30, 2012 was $9.8 million.

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The following table represents restricted stock activity for the nine months ended September 30, 2012:

	Shares	Wtd. Avg. Grant Price
Restricted shares outstanding, beginning of period	834,703	$31.89
Restricted shares granted	529,050	$31.50
Restricted shares canceled	(67,943)	$33.73
Restricted shares vested	(369,465)	$26.48
Restricted shares outstanding, end of period	926,345	$33.69

(4) Earnings Per Share

The Company computes earnings per share in accordance with FASB ASC 260-10. Under the guidance, unvested restricted stock grants that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing basic earnings per share (EPS) pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating securities according to dividends or dividend equivalents and their respective participation rights in undistributed earnings.

Basic earnings per share ("Basic EPS") has been computed using the weighted average number of common shares outstanding during each period. Diluted EPS for the three and nine month periods ended September 30, 2012 and 2011 assumes, as of the beginning of the period, exercise of stock options using the treasury stock method. Certain of our stock options that would potentially dilute Basic EPS in the future were also antidilutive for the three and nine month periods ended September 30, 2012 and 2011, and are discussed below.

The following is a reconciliation of the numerators and denominators used in the calculation of Basic and Diluted EPS for the three and nine month periods ended September 30, 2012 and 2011 (in thousands, except per share amounts):

	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	Income from Continuing Operations	Shares	Per Share Amount	Income from Continuing Operations	Shares	Per Share Amount
Basic EPS:						
Income from continuing operations, and Share Amounts	$3,122	42,901		$17,007	42,470	
Less: (Income) loss from continuing operations allocated to unvested shares	(68)	—		(326)	—	
Income from continuing operations allocated to common shares	$3,054	42,901	$0.07	$16,681	42,470	$0.39
Dilutive Securities:						
Plus: Income from continuing operations allocated to unvested shares	68	—		326	—	
Less: (Income) loss from continuing operations re-allocated to unvested shares	(68)	—		(324)	—	
Stock Options	—	70		—	208	
Diluted EPS:						
Income from continuing operations allocated to common shares, and assumed share conversions	$3,054	42,971	$0.07	$16,683	42,678	$0.39

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	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	Income from Continuing Operations	Shares	Per Share Amount	Income from Continuing Operations	Shares	Per Share Amount
Basic EPS:						
Income from continuing operations, and Share Amounts	$9,720	42,812		$63,938	42,365	
Less: (Income) loss from continuing operations allocated to unvested shares	(210)	—		(1,195)	—	
Income from continuing operations allocated to common shares	$9,510	42,812	$0.22	$62,743	42,365	$1.48
Dilutive Securities:						
Plus: Income from continuing operations allocated to unvested shares	210	—		1,195	—	
Less: (Income) loss from continuing operations re-allocated to unvested shares	(209)	—		(1,188)	—	
Stock Options	—	133		—	254	
Diluted EPS:						