

SWIFT ENERGY CO  
Form 10-Q  
November 04, 2010

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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, 2010  
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  No

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

Yes  No

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

Large  Accelerated  Non-accelerated  Smaller   
accelerated filer filer reporting

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filer

company

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

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

Common Stock	37,885,357 Shares
(\$01 Par Value)	(Outstanding at October
(Class of Stock)	31, 2010)

SWIFT ENERGY COMPANY

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010  
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Certification of CEO & CFO Pursuant to Section 1350		



Condensed Consolidated Balance Sheets  
 Swift Energy Company and Subsidiaries  
 (in thousands, except share amounts)

	September 30, 2010 (Unaudited)	December 31, 2009
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$5,508	\$38,469
Accounts receivable	38,109	54,273
Deferred tax assets	6,208	3,171
Other current assets	16,086	12,123
Current assets held for sale	564	564
<b>Total Current Assets</b>	<b>66,475</b>	<b>108,600</b>
Property and Equipment:		
Oil and gas properties, using full-cost accounting	3,800,736	3,530,110
Less – Accumulated depreciation, depletion, and amortization	(2,333,367)	(2,214,146)
<b>Property and Equipment, Net</b>	<b>1,467,369</b>	<b>1,315,964</b>
Other Long-Term Assets	13,079	10,201
<b>Total Assets</b>	<b>\$1,546,923</b>	<b>\$1,434,765</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable and accrued liabilities	\$71,144	\$60,823
Accrued capital costs	52,421	33,199
Accrued interest	10,139	3,745
Undistributed oil and gas revenues	4,950	5,837
<b>Total Current Liabilities</b>	<b>138,654</b>	<b>103,604</b>
Long-Term Debt	471,566	471,397
Deferred Income Taxes	150,803	123,577
Asset Retirement Obligation	58,650	55,298
Other Long-Term Liabilities	1,811	1,990
Commitments and Contingencies		
Stockholders' Equity:		
Preferred stock, \$.01 par value, 5,000,000 shares authorized, none outstanding	---	---
Common stock, \$.01 par value, 85,000,000 shares authorized, 38,322,622 and 37,887,126 shares issued, and 37,882,686 and 37,456,603 shares outstanding, respectively	383	379
Additional paid-in capital	562,429	551,606
Treasury stock held, at cost, 439,936 and 430,523 shares, respectively	(9,725 )	(9,221 )
Retained earnings	172,352	136,358
Accumulated other comprehensive loss, net of income tax	---	(223 )
<b>Total Stockholders' Equity</b>	<b>725,439</b>	<b>678,899</b>

Total Liabilities and Stockholders' Equity	\$1,546,923	\$1,434,765
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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 share amounts)

	Three Months Ended		Nine Months Ended	
	09/30/10	09/30/09	09/30/10	09/30/09
<b>Revenues:</b>				
Oil and gas sales	\$105,811	\$97,952	\$320,887	\$257,153
Price-risk management and other, net	(165 )	(1,689 )	1,505	(1,610 )
<b>Total Revenues</b>	<b>105,646</b>	<b>96,263</b>	<b>322,392</b>	<b>255,543</b>
<b>Costs and Expenses:</b>				
General and administrative, net	8,722	8,830	26,010	24,830
Depreciation, depletion, and amortization	40,800	41,011	118,103	125,310
Accretion of asset retirement obligation	998	732	2,927	2,151
Lease operating cost	20,977	18,513	59,561	57,139
Severance and other taxes	10,830	11,697	34,043	30,291
Interest expense, net	8,264	7,336	24,804	22,616
Write-down of oil and gas properties	---	---	---	79,312
<b>Total Costs and Expenses</b>	<b>90,591</b>	<b>88,119</b>	<b>265,448</b>	<b>341,649</b>
<b>Income (Loss) from Continuing Operations Before Income Taxes</b>				
	15,055	8,144	56,944	(86,106 )
<b>Provision (Benefit) for Income Taxes</b>	<b>5,652</b>	<b>586</b>	<b>20,788</b>	<b>(32,451 )</b>
<b>Income (Loss) from Continuing Operations</b>	<b>9,403</b>	<b>7,558</b>	<b>36,156</b>	<b>(53,655 )</b>
<b>Loss from Discontinued Operations, net of taxes</b>	<b>(73 )</b>	<b>(32 )</b>	<b>(162 )</b>	<b>(215 )</b>
<b>Net Income (Loss)</b>	<b>\$9,330</b>	<b>\$7,526</b>	<b>\$35,994</b>	<b>\$(53,870 )</b>
<b>Per Share Amounts-</b>				
<b>Basic: Income (Loss) from Continuing Operations</b>	<b>\$0.24</b>	<b>\$0.21</b>	<b>\$0.94</b>	<b>\$(1.66 )</b>
<b>Loss from Discontinued Operations, net of taxes</b>	<b>(0.00 )</b>	<b>(0.00 )</b>	<b>(0.00 )</b>	<b>(0.01 )</b>
<b>Net Income (Loss)</b>	<b>\$0.24</b>	<b>\$0.21</b>	<b>\$0.93</b>	<b>\$(1.67 )</b>
<b>Diluted: Income (Loss) from Continuing Operations</b>	<b>\$0.24</b>	<b>\$0.21</b>	<b>\$0.93</b>	<b>\$(1.66 )</b>
<b>Loss from Discontinued Operations, net of taxes</b>	<b>(0.00 )</b>	<b>(0.00 )</b>	<b>(0.00 )</b>	<b>(0.01 )</b>
<b>Net Income (Loss)</b>	<b>\$0.24</b>	<b>\$0.21</b>	<b>\$0.93</b>	<b>\$(1.67 )</b>
<b>Weighted Average Shares Outstanding</b>	<b>37,880</b>	<b>34,723</b>	<b>37,792</b>	<b>32,310</b>

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 (1)	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2008	\$313	\$435,307	\$(10,431 )	\$175,688	\$ -	\$600,877
Stock issued for benefit plans (94,023 shares)	-	(716 )	2,094	-	-	1,378
Stock options exercised (26,056 shares)	-	326	-	-	-	326
Public stock offering (6,210,000 shares)	62	108,689	-	-	-	108,751
Purchase of treasury shares (56,662 shares)	-	-	(884 )	-	-	(884 )
Tax benefits from stock compensation	-	(4,041 )	-	-	-	(4,041 )
Employee stock purchase plan (50,690 shares)	1	724	-	-	-	725
Issuance of restricted stock (263,908 shares)	3	(3 )	-	-	-	-
Amortization of stock compensation	-	11,320	-	-	-	11,320
Net loss	-	-	-	(39,330 )	-	(39,330 )
Other comprehensive loss	-	-	-	-	(223 )	(223 )
Total comprehensive loss						(39,553 )
Balance, December 31, 2009	\$379	\$551,606	\$(9,221 )	\$136,358	\$ (223 )	\$678,899
Stock issued for benefit plans (59,335 shares) (2)	-	242	1,271	-	-	1,513
Stock options exercised (63,298 shares) (2)	-	878	-	-	-	878
Purchase of treasury shares (68,748 shares) (2)	-	-	(1,775 )	-	-	(1,775 )
Employee stock purchase plan (66,564 shares) (2)	1	950	-	-	-	951
Issuance of restricted stock (305,634 shares) (2)	3	(3 )	-	-	-	-
Amortization of stock compensation (2)	-	8,756	-	-	-	8,756
Net Income (2)	-	-	-	35,994	-	35,994
Other comprehensive income (2)	-	-	-	-	223	223
Total comprehensive income (2)						36,217
Balance, September 30, 2010 (2)	\$383	\$562,429	\$(9,725 )	\$172,352	\$ ---	\$725,439

(1) \$.01 par value.

(2) 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,	
	2010	2009
<b>Cash Flows from Operating Activities:</b>		
Net income (loss)	\$35,994	\$(53,870 )
Plus loss from discontinued operations, net of taxes	162	215
Adjustments to reconcile net income (loss) to net cash provided by operation activities -		
Depreciation, depletion, and amortization	118,103	125,310
Write-down of oil and gas properties	---	79,312
Accretion of asset retirement obligation	2,927	2,151
Deferred income taxes	26,151	(21,927 )
Stock-based compensation expense	7,550	6,854
Other	473	8,282
Change in assets and liabilities-		
Decrease in accounts receivable	1,837	2,874
Decrease in accounts payable and accrued liabilities	(5,812 )	(4,119 )
Decrease in income taxes payable	(38 )	(293 )
Increase in accrued interest	6,394	1,387
Cash provided by operating activities – continuing operations	193,741	146,176
Cash used in operating activities – discontinued operations	(29 )	(366 )
<b>Net Cash Provided by Operating Activities</b>	<b>193,712</b>	<b>145,810</b>
<b>Cash Flows from Investing Activities:</b>		
Additions to property and equipment	(228,379 )	(164,504 )
Proceeds from the sale of property and equipment	133	4,589
Cash used in investing activities – continuing operations	(228,246 )	(159,915 )
Cash provided by investing activities – discontinued operations	5,000	5,000
<b>Net Cash Used in Investing Activities</b>	<b>(223,246 )</b>	<b>(154,915 )</b>
<b>Cash Flows from Financing Activities:</b>		
Net payments of bank borrowings	---	(99,900 )
Net proceeds from issuances of common stock	1,829	109,722
Purchase of treasury shares	(1,775 )	(846 )
Payments of debt issuance costs	(3,481 )	---
Cash provided by (used in) financing activities – continuing operations	(3,427 )	8,976
Cash provided by financing activities – discontinued operations	---	---
<b>Net Cash Provided by (Used in) financing activities</b>	<b>(3,427 )</b>	<b>8,976</b>
<b>Net decrease in Cash and Cash Equivalents</b>	<b>(32,961 )</b>	<b>\$(129 )</b>
<b>Cash and Cash Equivalents at Beginning of Period</b>	<b>38,469</b>	<b>283</b>
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$5,508</b>	<b>\$154</b>
<b>Supplemental Disclosures of Cash Flows Information:</b>		

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Cash paid during period for interest, net of amounts capitalized	\$17,521	\$20,190
Cash paid during period for income taxes	\$168	\$232

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, 2009 as filed with the Securities and Exchange Commission.

(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 natural gas properties, with a focus on inland waters and onshore oil and natural gas reserves in Louisiana and Texas. Our undivided interests in gas processing plants 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 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.** We have evaluated subsequent events of our consolidated financial statements. There were no material subsequent events requiring additional disclosure in or amendments to these financial statements.

**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 amount 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 therefrom,
  - 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 revenues, 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 stock compensation expense,
  - estimates of our ownership in properties prior to final division of interest determination,

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- 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.

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, 2010 and 2009, such internal costs capitalized totaled \$17.8 million and \$18.1 million, respectively. Interest costs are also capitalized to unproved oil and natural gas properties. For the nine months ended September 30, 2010 and 2009, capitalized interest on unproved properties totaled \$5.5 million and \$4.6 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.

	September 30, 2010	December 31, 2009
Property and Equipment (in thousands)		
Oil and gas properties, using full-cost accounting		
Proved properties	\$3,684,549	\$3,421,340
Unproved properties	78,878	71,640
Furniture, fixtures, and other equipment	37,309	37,130
Less – Accumulated depreciation, depletion, and amortization	(2,333,367)	(2,214,146)
Property and Equipment, Net	\$1,467,369	\$1,315,964

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 natural 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 natural 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 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"). We did not have any hedges at September 30, 2010 that would materially affect this calculation. This calculation is done on a country-by-country basis.



The calculation of the Ceiling Test and provision for depreciation, depletion, and amortization (“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.

As a result of low oil and natural gas prices at March 31, 2009, we reported a non-cash write-down on a before-tax basis of \$79.3 million on our oil and natural gas properties.

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 possible that additional non-cash write-downs of oil and natural gas properties could 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, additional non-cash write-downs of our oil and natural gas properties could 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, 2010, 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.

**Fair Value of Financial Instruments.** Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, bank borrowings, and senior notes. The carrying amounts of cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to the highly liquid or short-term nature of these instruments. The fair values of the bank borrowings approximate the carrying amounts as of September 30, 2010 and December 31, 2009, and were determined based upon variable interest rates currently available to us for borrowings with similar terms. Based upon quoted market prices as of September 30, 2010 and December 31, 2009, the fair value of our senior notes due 2017, were \$243.8 million, or 98% of face value, and 239.1 million, or 96% of face value, respectively. Based upon quoted market prices as of September 30, 2010 and December 31, 2009, the fair values of our senior notes due 2020, which were issued in November 2009, were \$235.2 million, or 105% of face value and 234.0 million, or 104% of face value, respectively. The carrying value of our senior notes due 2017 was \$250.0 million at September 30, 2010 and December 31, 2009, while the carrying value of our senior notes due 2020 was \$221.6 million and \$221.4 million at September 30, 2010 and December 31, 2009, respectively.

**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, 2010 and December 31, 2009, 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, 2010 our "Accounts Receivable" balance included \$35.3 million for oil and gas sales, \$1.8 million for joint interest owners and \$1.0 million for other receivables. At December 31, 2009 our "Accounts Receivable" balance included \$36.4 million for oil and gas sales, \$2.6 million for joint interest owners and \$15.3 million for other receivables.

Insurance Claims. In 2008, we filed insurance claims related to 2008 Hurricanes Gustav and Ike. In April 2009, we settled our marine insurance claim relating to Hurricane Gustav for a net amount after deductible of \$6.8 million, and in September 2009 settled our onshore claim relating to Hurricane Ike for a net amount after deductible of \$0.8 million. Both of these reimbursements related to both capital costs and lease operating expense, and we have no additional hurricane related claims outstanding.

We have several open insurance claims filed in the ordinary course of business, none of which are material at the present time.

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 balance sheet 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. During the third quarter of 2010 and 2009, we recognized a net loss of \$0.2 million and a net loss of \$1.3 million, respectively, relating to our derivative activities. During the first nine months of 2010 and 2009, we recognized a net gain of \$0.8 million and a net loss of \$1.3 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 losses been recognized in the oil and gas sales account they would not have materially changed our per unit sales prices received. At September 30, 2010, the Company had no derivative gains or losses in "Accumulated other comprehensive loss, net of income tax" on the accompanying condensed consolidated balance sheet. The ineffectiveness reported in "Price-risk management and other, net" at September 30, 2010 and 2009 was not material.

At September 30, 2010, we did not have any outstanding derivative instruments in place for future production.

When we entered into these transactions discussed above, 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 (loss), 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 (loss), net of income tax" on the accompanying condensed consolidated balance sheet and recorded in "Price-risk management and other, net" on the accompanying 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. The fair value of these instruments at September 30, 2010 and December 31, 2009, was zero and \$0.8 million, respectively and was recognized on the accompanying condensed consolidated balance sheet in "Other current assets."

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, to the extent they do not exceed actual costs incurred, are recorded as a reduction to "General and administrative, net." Our supervision fees are based on COPAS guidelines. The amount of supervision fees charged in the first nine months of 2010 and 2009 did not exceed our actual costs incurred. The total amount of supervision fees charged to the wells we operate was \$9.2 million and \$8.4

million in the first nine months of 2010 and 2009, respectively.

Inventories. Inventories consist primarily of tubulars and other equipment 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 \$12.5 million at September 30, 2010 and \$10.0 million at December 31, 2009.

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.

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. Our current balance of unrecognized tax benefits is \$1.0 million. If recognized, these tax benefits would fully impact our effective tax rate.

Our policy is to record interest and penalties relating to income taxes in income tax expense. As of September 30, 2010, 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, our Louisiana income tax returns from 1998 forward, our New Zealand income tax returns after 2003, and our Texas franchise tax returns after 2006 remain subject to examination by the taxing authorities. There are no material unresolved items related to periods previously audited by these taxing authorities. No other state returns are significant to our financial position.

Accounts Payable and Accrued Liabilities. Included in “Accounts payable and accrued liabilities,” on the accompanying condensed consolidated balance sheets, at September 30, 2010 and December 31, 2009 are liabilities of approximately \$8.3 million and \$7.5 million, respectively, which represent the amounts by which checks issued, but not presented by vendors to the Company’s banks for collection, exceeded balances in the applicable disbursement bank accounts.

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, 2010 and December 31, 2009 these assets include approximately \$1.3 million in other long-term assets on the balance sheet. 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.

Accumulated Other Comprehensive Income (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, 2010, the Company had recorded no gains or losses in “Accumulated other comprehensive income (loss), net of income tax” on the accompanying condensed consolidated balance sheet. The components of accumulated other comprehensive income and related tax effects for 2010 were as follows (in thousands):

	Gross Value	Tax Effect	Net of Tax Value
Other comprehensive loss at December 31, 2009	\$(354 )	\$131	\$(223 )
Change in fair value of cash flow hedges	1,086	(400 )	686
Effect of cash flow hedges settled during the period	(732 )	269	(463 )
Other comprehensive income at September 30, 2010	\$---	\$---	\$---

Total comprehensive income was \$9.3 million and \$7.7 million for the third quarters of 2010 and 2009, respectively. Total comprehensive income (loss) was \$36.2 million and (\$53.9) million for the nine months of 2010 and 2009, respectively.

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 full cost balance. 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)	2010	2009
Asset Retirement Obligation recorded as of January 1	\$64,236	\$48,785
Accretion expense	2,927	2,151
Liabilities incurred for new wells and facilities construction	1,018	3,302
Reductions due to sold and abandoned wells	(463 )	(1,255 )
Revisions in estimated cash flows	---	336
Asset Retirement Obligation as of September 30	\$67,718	\$53,319

At September 30, 2010 and December 31, 2009, approximately \$9.1 million and \$8.9 million, respectively, of our asset retirement obligation are classified as a current liability in “Accounts payable and accrued liabilities” on the accompanying condensed consolidated balance sheets.

**Public Stock Offering.** In August 2009, we issued 6.21 million shares of our common stock in an underwritten public offering at a price of \$18.50 per share. The gross proceeds from these sales were approximately \$114.9 million, before deducting underwriting commissions and issuance costs totaling \$6.1 million.

**New Accounting Pronouncements.** In January 2010, the FASB issued ASU 2010-03 to amend oil and gas reserve accounting and disclosure guidance that aligns the oil and gas reserve estimation and disclosure requirements of Topic 932 (“Extractive Industries – Oil and Gas”) with the requirements of SEC Release No. 33-8995. This release is effective for financial statements issued on or after January 1, 2010. We have adopted this guidance for all reporting periods ending on or after December 31, 2009. This release changes the accounting and disclosure requirements surrounding oil and natural gas reserves and is intended to modernize and update the oil and gas disclosure requirements, to align them with current industry practices and to adapt to changes in technology. The most significant changes include:

- Changes to prices used in reserves calculations, for use in both disclosures and accounting impairment tests. Prices will no longer be based on a single-day, period-end price. Rather, they will be based on either the preceding 12-months’ average price based on closing prices on the first day of each month, or prices defined by existing contractual arrangements.
  - Disclosure of probable and possible reserves is allowed.
- The estimation of reserves will allow the use of reliable technology that was not previously recognized by the SEC.
  - Numerous changes in reserves disclosures mandated by SEC Form 10-K.
- Reserves may be classified as proved undeveloped if there is a high degree of confidence that the quantities will be recovered and they are scheduled to be drilled within the next five years, unless the specific circumstances justify a longer time.

The change in prices used to calculate reserves did not have a material impact upon our reserves estimation in the current period. These changes could have a material impact upon our financial statements in future periods due to the uncertainty of oil and gas prices.

### (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 10K for the fiscal year ended December 31, 2009, 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 price at which the stock is sold 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, 2010, we did not recognize any excess tax benefit or shortfall. For the nine months ended September 30, 2009, we recognized a tax benefit shortfall of \$2.3 million as restricted stock vested at a lower value than the value used to record compensation expense at the date of grant, offset by a reduction to additional paid-in capital.



Net cash proceeds from the exercise of stock options were \$0.9 million and \$0.2 million for the nine months ended September 30, 2010 and 2009. The actual income tax benefit from stock option exercises was \$0.2 million for the nine months ended September 30, 2010 and less than \$0.1 million for the nine months ended September 30, 2009.

Stock compensation expense for both stock options and restricted stock issued to both employees and non-employees, which were recorded in "General and administrative, net" in the accompanying condensed consolidated statements of operations, were \$2.4 million and \$2.1 million for the quarters ended September 30, 2010 and 2009, respectively, and were \$6.9 million and \$6.2 million for the nine month periods ended September 30, 2010 and 2009. Stock compensation recorded in lease operating cost was \$0.1 million for the quarters ended September 30, 2010 and 2009, and was \$0.3 million for the nine month periods ended September 30, 2010 and 2009. We also capitalized \$0.4 million and \$0.5 million of stock compensation in the third quarters of 2010 and 2009, respectively, and capitalized \$1.2 million and \$1.6 million of stock compensation in the nine month periods ended September 30, 2010 and 2009, 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 service period 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:

	Three Months Ended		Nine Months Ended			
	September 30,		September 30,			
	2010	2009	2010		2009	
Dividend yield	N/A	N/A	0	%	0	%
Expected volatility	N/A	N/A	63.0	%	50.5	%
Risk-free interest rate	N/A	N/A	2.1	%	1.8	%
Expected life of options (in years)	N/A	N/A	4.3		4.5	
Weighted-average grant-date fair value	N/A	N/A	\$12.60		\$6.32	

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 2010 and 2009 stock option grants.

At September 30, 2010, we had \$2.3 million of unrecognized compensation cost related to stock options, which is expected to be recognized over a weighted-average period of 1.1 years. The following table represents stock option activity for the nine months ended September 30, 2010:

	Shares	Wtd. Avg. Exercise Price
Options outstanding, beginning of period	1,289,194	\$29.72
Options granted	267,378	\$24.95
Options canceled	(36,983 )	\$44.65
Options exercised	(84,676 )	\$17.92
Options outstanding, end of period	1,434,913	\$29.00
Options exercisable, end of period	828,666	\$30.73

The aggregate intrinsic value and weighted average remaining contract life of options outstanding and exercisable at September 30, 2010 was \$7.8 million and 5.7 years and \$4.5 million and 3.9 years, respectively. Total intrinsic value of options exercised during the nine months ended September 30, 2010 was \$1.1 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, 2009, 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, 2010, we had unrecognized compensation expense of \$10.4 million related to restricted stock awards which is expected to be recognized over a weighted-average period of 1.1 years. The grant date fair value of shares vested during the nine months ended September 30, 2010 was \$8.8 million.

The following table represents restricted stock activity for the nine months ended September 30, 2010:

	Shares	Wtd. Avg. Grant Price
Restricted shares outstanding, beginning of period	703,856	\$24.15
Restricted shares granted	375,450	\$25.08
Restricted shares canceled	(37,633 )	\$25.12
Restricted shares vested	(305,634 )	\$28.87
Restricted shares outstanding, end of period	736,039	\$22.65

## (4) Earnings Per Share

The Company computes earnings per share in accordance with FASB ASC 260-10. Under the guidance, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing 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. Unvested share-based payments that contain non-forfeitable rights to dividends or dividend equivalents are now included in the basic weighted average share calculation under the two-class method. These shares were previously included in the diluted weighted average share calculation under the treasury stock method.

Basic earnings per share ("Basic EPS") has been computed using the weighted average number of common shares outstanding during each period. As we recognized a net loss for the first nine months of 2009, the unvested share-based payments and stock options were not recognized in diluted earnings per share ("Diluted EPS") calculations as they would be antidilutive. Diluted EPS for the quarter ended September 30, 2010 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, 2010, and are discussed below.

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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, 2010 and 2009 (in thousands, except per share amounts):

	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009		
	Income from Continuing Operations	Shares	Per Share Amount	Income from Continuing Operations	Shares	Per Share Amount
<b>Basic EPS:</b>						
Income (Loss) from continuing operations, and Share Amounts	\$9,403	37,880		\$7,558	34,723	
Less: Income (Loss) from continuing operations allocated to unvested shareholders	(179 )	---		(153 )	---	
Income (Loss) from continuing operations allocated to common shares	\$9,224	37,880	\$0.24	\$7,405	34,723	\$0.21
<b>Dilutive Securities:</b>						
Plus: Income (Loss) from continuing operations allocated to unvested shareholders	179	---		153	---	
Less: Income (Loss) from continuing operations re-allocated to unvested shareholders	(178 )	---		(152 )	---	
Stock Options	---	178		---	110	
<b>Diluted EPS:</b>						
Income (Loss) from continuing operations allocated to common shares, and assumed share conversions	\$9,225	38,058	\$0.24	\$7,406	34,833	\$0.21

	Nine Months Ended September 30, 2010			Nine Months Ended September 30, 2009		
	Income from Continuing Operations	Shares	Per Share Amount	Income from Continuing Operations	Shares	Per Share Amount
<b>Basic EPS:</b>						
Income (Loss) from continuing operations, and Share Amounts	\$36,156	37,792		\$(53,655 )	32,310	
Less: Income (Loss) from continuing operations allocated to unvested shareholders	(693 )	---		---	---	
Income (Loss) from continuing operations allocated to common	\$35,463	37,792	\$0.94	\$(53,655 )	32,310	\$(1.66 )

shares

Dilutive Securities:

Plus: Income (Loss) from  
continuing operations allocated  
to unvested shareholders

693

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Less: Income (Loss) from  
continuing operations  
re-allocated to unvested  
shareholders