

COMSTOCK RESOURCES INC
Form 10-Q
August 11, 2008

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

FORM 10-Q

(Mark One)

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

For The Quarterly Period Ended June 30, 2008

OR

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

Commission File No. 001-03262

COMSTOCK RESOURCES, INC.
(Exact name of registrant as specified in its charter)

NEVADA
(State or other jurisdiction of
incorporation or organization)

94-1667468
(I.R.S. Employer
Identification Number)

5300 Town and Country Blvd., Suite 500, Frisco, Texas 75034
(Address of principal executive offices)

Telephone No.: (972) 668-8800

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated

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filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes No

The number of shares outstanding of the registrant's common stock, par value \$.50, as of August 8, 2008 was 46,016,345.

COMSTOCK RESOURCES, INC.

QUARTERLY REPORT

For The Quarter Ended June 30, 2008

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2008	December 31, 2007
ASSETS		
(In thousands)		
Cash and Cash Equivalents	\$ 8,709	\$ 5,565
Accounts Receivable: Oil and gas sales	63,258	36,245
Joint interest operations	10,706	12,406
Current Deferred Tax Asset	10,140	—
Other Current Assets	5,162	3,987
Total current assets	97,975	58,203
Property and Equipment: Unevaluated oil and gas properties	19,362	5,804
Oil and gas properties, successful efforts method	1,798,610	1,812,637
Other property and equipment	5,487	5,013
Accumulated depreciation, depletion and amortization	(547,275)	(512,895)
Net property and equipment	1,276,184	1,310,559
Other Assets	3,554	3,943
Assets of Discontinued Operations	1,031,982	981,682
	\$ 2,409,695	\$ 2,354,387

LIABILITIES AND STOCKHOLDERS' EQUITY

Accounts Payable	\$ 85,415	\$ 71,579
Accrued Expenses	11,193	11,888
Derivatives	29,331	—
	125,939	83,467

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Total current liabilities		
Long-term Debt	495,000	680,000
Deferred Income Taxes Payable	132,198	92,088
Derivatives	10,749	—
Reserve for Future Abandonment Costs	7,555	7,512
Liabilities of Discontinued Operations	434,775	452,235
Minority Interest in Discontinued Operations	311,306	267,441
Total liabilities	1,517,522	1,582,743
Commitments and Contingencies		
Stockholders' Equity:		
Common stock – \$0.50 par, 50,000,000 shares authorized, 46,016,345 and 45,428,095 shares outstanding at June 30, 2008 and December 31, 2007, respectively	23,008	22,714
Additional paid-in capital	409,318	386,986
Retained earnings	485,666	361,944
Accumulated other comprehensive loss	(25,819)	—
Total stockholders' equity	892,173	771,644
	\$ 2,409,695	\$ 2,354,387

The accompanying notes are an integral part of these statements.

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007

(In thousands, except per share amounts)

Revenues:				
Oil and gas sales	\$ 172,022	\$ 83,160	\$ 299,743	\$ 153,007
Gain on sale of assets	21,444	—	21,204	—
Operating expenses:				
Oil and gas operating	23,362	17,624	44,564	31,679
Exploration	—	1,878	2,238	2,276
Depreciation, depletion and amortization	44,422	30,248	85,927	57,608
General and administrative, net	6,922	5,588	13,086	11,838
Total operating expenses	74,706	55,338	145,815	103,401
Operating income from continuing operations	118,760	27,822	175,132	49,606
Other income (expenses):				
Interest income	205	197	366	388
Other income	36	39	58	77
Interest expense	(8,546)	(7,775)	(18,497)	(14,060)
Total other income (expenses)	(8,305)	(7,539)	(18,073)	(13,595)
Income from continuing operations before income taxes	110,455	20,283	157,059	36,011
Provision for income taxes	(40,027)	(7,312)	(57,229)	(13,641)
Income from continuing operations	70,428	12,971	99,830	22,370
Income from discontinued operations after income taxes and minority interest	12,199	5,246	23,892	8,405
Net income	\$ 82,627	\$ 18,217	\$ 123,722	\$ 30,775
Basic net income per share:				
Continuing operations	\$ 1.59	\$ 0.30	\$ 2.25	\$ 0.52
Discontinued operations	0.28	0.12	0.54	0.19
	\$ 1.87	\$ 0.42	\$ 2.79	\$ 0.71
Diluted net income per share:				
Continuing operations	\$ 1.55	\$ 0.29	\$ 2.21	\$ 0.51
Discontinued operations	0.26	0.12	0.51	0.18
	\$ 1.81	\$ 0.41	\$ 2.72	\$ 0.69

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Weighted average shares outstanding:

Basic	44,287	43,374	44,296	43,369
Diluted	45,373	44,361	45,246	44,300

The accompanying notes are an integral part of these statements.

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME
For the Six Months Ended June 30, 2008
(Unaudited)

	Common Stock (Shares)	Common Stock – Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
(In thousands)						
Balance at January 1, 2008	\$ 45,428	\$ 22,714	\$ 386,986	\$ 361,944	\$ —	\$ 771,644
Exercise of stock options and warrants	591	296	7,982	—	—	8,278
Stock-based compensation	(3)	(2)	5,718	—	—	5,716
Tax benefit from stock-based compensation	—	—	8,632	—	—	8,632
Net income	—	—	—	123,722	—	123,722
Unrealized hedging losses, net of income taxes	—	—	—	—	(25,819)	(25,819)
Total comprehensive income	—	—	—	—	—	97,903
Balance at June 30, 2008	\$ 46,016	\$ 23,008	\$ 409,318	\$ 485,666	\$ (25,819)	\$ 892,173

The accompanying notes are an integral part of these statements.

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30,	
	2008	2007
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 123,722	\$ 30,775
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations	(23,892)	(8,405)
Deferred income taxes	52,504	11,846
Dry hole costs and leasehold impairments	2,238	2,276
Depreciation, depletion and amortization	85,927	57,608
Gain on sale of assets	(21,204)	—
Debt issuance cost amortization	405	405
Stock-based compensation	5,716	5,261
Excess tax benefit from stock-based compensation	(8,632)	(600)
Unrealized loss on derivatives	359	—
Increase in accounts receivable	(25,316)	(10,839)
(Decrease) increase in other current assets	(1,175)	57
Increase in accounts payable and accrued expenses	10,078	28,687
Net cash provided by operating activities from continuing operations	200,730	117,071
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(143,281)	(205,804)
Proceeds from asset sales	113,801	—
Net cash used for investing activities from continuing operations	(29,480)	(205,804)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings	10,000	114,000
Principal payments on debt	(195,000)	—
Proceeds from issuance of common stock	8,278	138
Excess tax benefit from stock-based compensation	8,632	600
Debt issuance costs	(16)	—
Net cash provided by (used for) financing activities from continuing operations	(168,106)	114,738
CASH FLOWS FROM DISCONTINUED OPERATIONS:		
Net cash flows provided by operating activities	180,143	98,254
Net cash flows used for investing activities	(117,013)	(123,541)
Net cash flows provided by (used for) financing activities	(63,130)	25,221
Net cash used for discontinued operations	—	(66)

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Net increase in cash and cash equivalents	3,144	25,939
Cash and cash equivalents, beginning of period	5,565	1,228
Cash and cash equivalents, end of period	\$ 8,709	\$ 27,167

The accompanying notes are an integral part of these statements.

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COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008

(Unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES –

Basis of Presentation

In management's opinion, the accompanying unaudited consolidated financial statements contain all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the financial position of Comstock Resources, Inc. and subsidiaries ("Comstock" or the "Company") as of June 30, 2008 and the related results of operations for the three months and six months ended June 30, 2008 and 2007 and cash flows for the six months ended June 30, 2008 and 2007.

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted pursuant to those rules and regulations, although Comstock believes that the disclosures made are adequate to make the information presented not misleading. These unaudited consolidated financial statements should be read in conjunction with the financial statements and notes thereto of the Company included in Comstock's Annual Report on Form 10-K for the year ended December 31, 2007.

The results of operations for the three months and six months ended June 30, 2008 are not necessarily an indication of the results expected for the full year.

These unaudited consolidated financial statements include the accounts of Comstock and subsidiaries in which it has a controlling interest. Intercompany balances and transactions have been eliminated in consolidation.

Comstock's offshore operations have historically been conducted through its subsidiary, Bois d'Arc Energy, Inc. ("Bois d'Arc Energy"). Bois d'Arc Energy has entered into a definitive merger agreement with Stone Energy Corporation ("Stone") in which Bois d'Arc Energy stockholders will exchange each share of Bois d'Arc Energy common stock for \$13.65 in cash and 0.165 shares of Stone common stock. Subsequent to this merger, Comstock's stock ownership of Stone will be less than a controlling interest. The merger agreement has been approved by the respective boards' of directors of Bois d'Arc Energy and Stone, and the stockholders of Bois d'Arc Energy and Stone will be holding stockholder meetings on August 27, 2008 to consider and vote upon the proposed merger. The Company has entered into a voting agreement with Stone in which among other matters Comstock has agreed to vote its shares in favor of the merger. The Company believes it is highly likely that the stockholders of both companies will approve the merger and that the merger will close during the third quarter of 2008. Accordingly, the Company is presenting the results of the offshore operations of Bois d'Arc Energy as discontinued operations. Below is the summary financial information of discontinued operations.

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

Income from discontinued operations for the three and six months ended June 30, 2008 was comprised of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In thousands)			
Oil and Gas Sales	\$ 147,990	\$ 91,046	\$ 261,256	\$ 167,228
Total Operating Expenses	(87,039)	(62,630)	(141,126)	(119,192)
Operating Income From Discontinued Operations	60,951	28,416	120,130	48,036
Other Income (Expense):	(745)	(2,111)	(1,890)	(4,078)
Income from Discontinued Operations Before Income Taxes	60,206	26,305	118,240	43,958
Provision for Income Taxes	(27,715)	(12,249)	(54,586)	(20,744)
Minority Interest in Earnings	(20,292)	(8,810)	(39,762)	(14,809)
Income from Discontinued Operations	\$ 12,199	\$ 5,246	\$ 23,892	\$ 8,405

Assets and liabilities of discontinued operations as of June 30, 2008 and December 31, 2007 were as follows:

	June 30, 2008	December 31, 2007
	(In thousands)	
Current Assets	\$ 83,094	\$ 66,302
Property and Equipment, Net	948,314	912,316
Other Assets	574	3,064
Total Assets of Discontinued Operations	\$ 1,031,982	\$ 981,682
Current Liabilities	\$ 78,924	\$ 47,333
Long-term Debt	—	80,000
Deferred Income Taxes Payable	309,739	279,808
Reserve for Future Abandonment Costs	46,112	45,094
Liabilities of Discontinued Operations	\$ 434,775	\$ 452,235
Minority Interest in Bois d'Arc Energy	\$ 311,306	\$ 267,441

Reclassifications

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

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

Asset Retirement Obligations

Comstock's asset retirement obligations relate to future plugging and abandonment expenses on its oil and gas properties and related facilities disposal. The following table summarizes the changes in Comstock's total estimated liability during the six months ended June 30, 2008 and 2007:

	Six Months Ended	
	June 30,	
	2008	2007
	(In thousands)	
Beginning asset retirement obligations	\$ 7,512	\$ 9,052
Accretion expense	227	267
New wells placed on production and changes in estimates	313	253
Liabilities settled	(497)	(98)
Future abandonment liability — end of period	\$ 7,555	\$ 9,474

Derivative Instruments and Hedging Activities

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

In January 2008, Comstock entered into natural gas swaps which fix the price at \$8.00 per Mmbtu (at the Houston Ship Channel) for 520,000 Mmbtu's per month of production from certain properties in South Texas for the period February 2008 through December 2009. The Company designated these swaps at their inception as cash flow hedges. Realized gains and losses are included in oil and natural gas sales in the month of production. Changes in the fair value of derivative instruments designated as cash flow hedges to the extent they are effective in offsetting cash flows attributable to the hedged risk are recorded in other comprehensive income until the hedged item is recognized in earnings. Any change in fair value resulting from ineffectiveness is recognized currently in oil and natural gas sales as unrealized gains (losses). The Company realized losses of \$4.4 million and \$4.6 million on the natural gas price swaps during the three and six months ended June 30, 2008, respectively, which are included in oil and gas sales in the accompanying Consolidated Statements of Operations. As of June 30, 2008, the estimated fair value of the Company's derivative financial instruments, which equals their carrying value, was a liability of \$40.1 million, of which \$29.3 million was classified as current and \$10.8 million was classified as long-term.

The Company had no derivative financial instruments outstanding during the six months ended June 30, 2007.

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

Stock-Based Compensation

Comstock accounts for employee stock-based compensation under the fair value method. Compensation cost is measured at the grant date based on the fair value of the award and is recognized over the award vesting period. During the three months ended June 30, 2008 and 2007, the Company recognized \$3.1 million and \$2.6 million, respectively, in stock-based compensation expense within general and administrative expenses related to stock option and restricted stock grants. Stock based compensation expense for the six months ended June 30, 2008 and 2007 was \$5.7 million and \$5.3 million, respectively. The excess income tax benefit realized from the deductions associated with stock-based compensation for the six months ended June 30, 2008 and 2007 was \$8.6 million and \$0.6 million, respectively.

The fair value of stock option grants is estimated on the date of the grant using a Black-Scholes option pricing model. Some of the inputs to the option valuation model are subjective, including assumptions regarding expected stock price volatility. During the six months ended June 30, 2008, Comstock granted options to purchase 40,000 shares at an exercise price of \$54.36 per share. The fair value of the options awarded was determined to be \$19.76 per share. Assumptions used to value these stock options included expected volatility of 38.9%, expected lives of 4.3 years, a risk-free interest rate of 3.3% and an expected dividend yield of zero. As of June 30, 2008, total unrecognized compensation cost related to nonvested stock options of \$2.2 million is expected to be recognized over a period of 2.5 years. Options outstanding at June 30, 2008 totaled 456,870, of which 305,120 were exercisable.

As of June 30, 2008, Comstock had 1.3 million shares of unvested restricted stock outstanding at a weighted average grant date fair value of \$31.58 per share. Total unrecognized compensation cost related to the unvested restricted stock grants of \$25.1 million as of June 30, 2008 is expected to be recognized over a period of 3.5 years.

Income Taxes

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Tax at statutory rate	35.0%	35.0%	35.0%	35.0%
Tax effect of:				
Non deductible stock-based compensation	0.4%	2.2%	0.9%	3.2%
Changes due to tax law changes	—%	(3.8%)	—%	(2.1%)
State income taxes, net of federal benefit	0.7%	2.2%	0.8%	1.8%
Other	0.1%	0.5%	(0.3%)	—%
Effective tax rate	36.2%	36.1%	36.4%	37.9%

COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

The following is an analysis of consolidated income tax expense from continuing operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In thousands)			
Current provision	\$ 2,754	\$ 950	\$ 4,725	\$ 1,795
Deferred provision	37,273	6,362	52,504	11,846
Provision for Income Taxes	\$ 40,027	\$ 7,312	\$ 57,229	\$ 13,641

Earnings Per Share

Basic earnings per share is determined without the effect of any outstanding potentially dilutive stock options or unvested restricted stock and diluted earnings per share is determined with the effect of outstanding stock options and unvested restricted stock that are potentially dilutive. Basic and diluted earnings per share for the three months and six months ended June 30, 2008 and 2007, respectively, were determined as follows:

	Three Months Ended June 30,					
	2008		2007			
	Income	Shares	Per Share	Income	Shares	Per Share
	(In thousands, except per share amounts)					
Basic Earnings Per Share:						
Income From Continuing Operations	\$ 70,428	44,287	\$ 1.59	\$ 12,971	43,374	\$ 0.30
Income from Discontinued Operations After Income Taxes and Minority Interest	12,199	44,287	0.28	5,246	43,374	0.12
Net Income	\$ 82,627	44,287	\$ 1.87	\$ 18,217	43,374	\$ 0.42
Diluted Earnings Per Share:						
Income from Continuing Operations	\$ 70,428	44,287	\$ 1.59	\$ 12,971	43,374	\$ 0.30
Effect of Dilutive Securities: Stock Grants and Options	—	1,086		—	987	
Income from Continuing Operations With Assumed Conversions	\$ 70,428	45,373	\$ 1.55	\$ 12,971	44,361	\$ 0.29
	\$ 12,199	45,373	\$ 0.27	\$ 5,246	44,361	\$ 0.12

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Income from Discontinued Operations After Income Taxes and Minority Interest						
Effect of Dilutive Securities:						
Stock Grants and Options	(361)	—		(160)	—	
Income from Discontinued Operations, After Income Taxes and Minority Interest with Assumed Conversions	11,838	45,373	0.26	5,086	44,361	0.12
Net Income	\$ 82,266	45,373	\$ 1.81	\$ 18,057	44,361	\$ 0.41

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COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

	Six Months Ended June 30,					
	2008			2007		
	Income	Shares	Per Share	Income	Shares	Per Share
(In thousands, except per share amounts)						
Basic Earnings Per Share:						
Income From Continuing Operations	\$ 99,830	44,296	\$ 2.25	\$ 22,370	43,369	\$ 0.52
Income from Discontinued Operations After Income Taxes and Minority Interest	23,892	44,296	0.54	8,405	43,369	0.19
Net Income	\$ 123,722	44,296	\$ 2.79	\$ 30,775	43,369	\$ 0.71
Diluted Earnings Per Share:						
Income from Continuing Operations	\$ 99,830	44,296	\$ 2.25	\$ 22,370	43,369	\$ 0.52
Effect of Dilutive Securities: Stock Grants and Options	—	950		—	931	
Income from Continuing Operations With Assumed Conversions	\$ 99,830	45,246	\$ 2.21	\$ 22,370	44,300	\$ 0.51
Income from Discontinued Operations After Income Taxes and Minority Interest	\$ 23,892	44,246	\$ 0.53	\$ 8,405	44,300	\$ 0.19
Effect of Dilutive Securities: Stock Grants and Options	(675)	—		(255)	—	
Income from Discontinued Operations After Income Taxes and Minority Interest with Assumed Conversions	23,217	45,246	0.51	8,150	44,300	0.18
Net Income	\$ 123,047	45,246	\$ 2.72	\$ 30,520	44,300	\$ 0.69

Stock options to purchase common stock at exercise prices in excess of the average actual stock price for the period that were anti-dilutive and that were excluded from the determination of diluted earnings per share are as follows:

Three Months Ended

Six Months Ended

June 30,