

COMSTOCK RESOURCES, INC.



1998 ANNUAL REPORT

Comstock Resources, Inc. is a fast growing independent energy company based in Dallas, Texas engaged in the acquisition, development, production and exploration of oil and natural gas. Comstock's operations are focused in the Gulf of Mexico, East Texas and North Louisiana.

## Major Properties







### Performance Highlights

(in thousands except per share data)

	1994	1995	1996	1997	1998
<b>Financial Highlights</b>					
Revenues	\$ 17,599	\$ 22,374	\$ 70,955	\$ 89,344	\$ 93,235
Net income (loss) (a)	\$ (1,106)	\$(31,333)(b)	\$ 24,066	\$ 21,746	\$(17,168)(b)
Per Common Share	(9¢)	\$ (2.50)(b)	\$ 1.23	85¢	(71¢)(b)
Cash from operations (c)	\$ 6,626	\$ 8,669	\$ 43,111	\$ 62,608	\$ 50,163
Per Common Share	46¢	49¢	\$ 2.03	\$ 2.41	\$ 2.00
Total assets	\$ 91,571	\$120,099	\$222,002	\$456,800	\$429,672
Total debt	\$ 37,932	\$ 71,811	\$ 80,108	\$260,000	\$278,104
Stockholders' equity	\$ 41,205	\$ 30,128	\$118,216	\$124,594	\$109,663

(a) From continuing operations and before extraordinary items.

(b) Includes non-cash after tax charge for impairment of oil and gas properties of \$29 million (\$2.32 per share) and \$11 million (46¢ per share) in 1995 and 1998, respectively.

(c) From continuing operations and before changes in working capital.

### Operational Highlights

Capital expenditures	\$ 16,386	\$ 61,809	\$111,962	\$ 254,843	\$ 67,387
Net producing wells	182.7	395.7	266.1	294.0	311.7
Natural gas production (MMcf per day)	17.8	25.5	53.1	62.6	73.2
Oil production (Barrels per day)	720	974	2,601	3,680	7,044
Proved gas reserves (MMcf)	92,840	173,165	234,444	240,117	250,402
Proved oil reserves (MBbls)	5,119	3,779	8,994	20,927	20,245





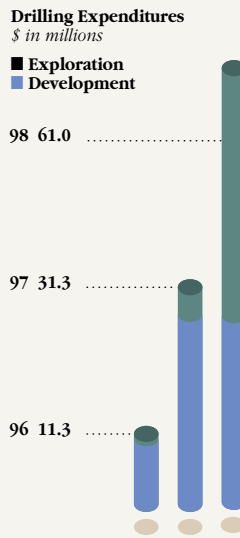
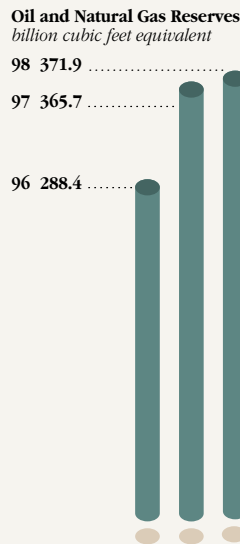
Production test for the  
SL 15071 #4 ('Snapper')  
at South Pelto 1



**Liftboat modifying South Pelto 1 facilities for new well**

**To Our Stockholders:**

1998 was a challenging year for Comstock. We had a very successful drilling program in 1998 and for the first year in our operating history we increased our oil and gas reserves and production exclusively with our drill bit activities. We were able to replace 115% of our 1998 production with our 1998 Gulf of Mexico exploration program, which represented a significant milestone for the Company. In prior years we grew almost exclusively through our acquisition activities. 1998 also saw a substantial decline in oil and gas prices and a substantial loss of market value for almost all companies in the oil and gas exploration and production sector. Despite the successes we had in our exploration program, our



share price deteriorated during 1998 along with the other companies in this sector. In a year where the



industry faced substantial set backs, we feel that 1998 was a successful year for Comstock based on the solid results that the Company achieved.

**East Texas / North Louisiana Region**

We had another successful year exploiting our properties in our East Texas / North Louisiana region. Our properties in this region are characterized by long lived natural gas reserves which produce from relatively tight sands in the Hosston, Travis Peak and Cotton Valley formations. The



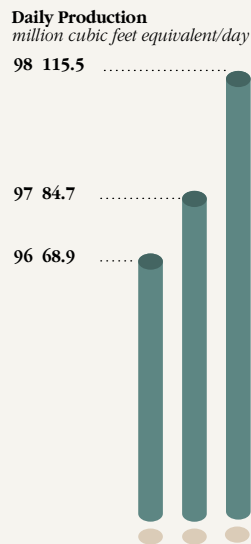


Production facilities at  
South Timbalier 34



Rigs drilling the SL 10830 #4 and the SL 10830 #5 wells at Ship Shoal 66

focus of our program in this region is drilling infill natural gas development wells. In 1998 we drilled 29 wells in this region (28 development wells and one exploratory well or 17.3 net wells). All but four of these wells were successful for a success rate of 86%. The successful wells had an initial production (“IP”) rate which averaged 1.9 million cubic feet of natural gas equivalent per day per well. Based on their IP rates, these new wells added 20 million cubic feet of natural gas equivalent to the Company’s net daily production. The successful development wells resulted in Comstock converting 14 Bcfe of reserves from the proved undeveloped category to the proved producing category at the end of 1998.



### Gulf of Mexico Region

In its first year, our Gulf of Mexico exploratory program turned in exceptional results. Comstock’s program in the Gulf of Mexico region in 1998 included drilling 15 wells (two development wells and 13 exploratory wells or 8.1 net wells). The two development wells were unsuccessful. Eight of the 13 exploratory wells resulted in new discoveries which added 56 Bcfe to our proved oil and gas reserve base at year end, which more than replaced our 1998 production. Three of the eight discoveries were placed on production by the end of 1998 with an average IP rate of 10.9 million cubic feet of natural gas equivalent per day per well. These wells added 24 million cubic feet of natural gas equivalent per day to the





Rig drilling the OCS-G 12027 #3  
discovery well at South Pelto 5





**Production platform at Ship Shoal 66 B**

Company's net daily production based on their IP rates. We expect to bring the remaining five discoveries on line by mid 1999 along with an additional new discovery we made in January 1999. These wells are currently shut in until production facilities can be put in place.

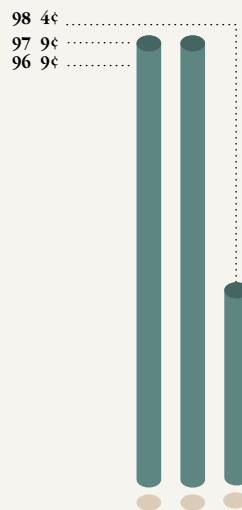
**Financial Results**

Our financial results in 1998 were a product of strong production growth, weak oil and gas prices and our low cost structure. Our oil and gas production increased by 36% to 42.1 Bcfe, the highest level in the Company's history. The production increases were a result of our acquisition of offshore properties at the end of 1997 as well as new production from our drilling activities. Our realized oil and gas prices

**Cash Flow per Share**



**G & A Expense**  
*Per thousand cubic feet equivalent*



decreased in 1998 from 1997 by 23%. As a result of the production increases and the price decreases, our revenues increased slightly in 1998 by 4% to \$93 million. We were able to keep our operating costs low in 1998. Oil and gas operating costs per Mcfe produced increased slightly in 1998 to 59¢ from 58¢ in 1997. However, we were able to substantially reduce our general and administrative expense per Mcfe produced to 4¢ in 1998 down from 9¢ in 1997. As a result of the substantial drop in oil and gas prices at the end of 1998, we took a \$17 million (\$11 million, after tax) impairment of our oil and gas properties. In addition, we incurred \$8 million in write-offs for exploratory dry holes in 1998. This impairment and the write-offs were the primary



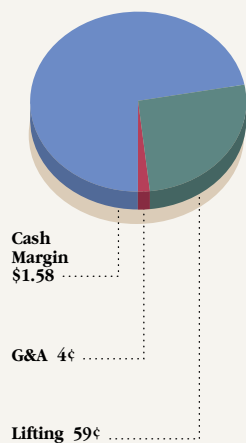
**Central production and storage facility for the Ship Shoal/South Pelto area**

contributor to the \$17 million loss we incurred in 1998 after posting strong profits in 1996 and 1997.

**Outlook for 1999**

Oil and gas prices have continued to fall in the first part of 1999. As with most companies in the sector, prolonged low oil and gas prices will negatively impact our operations and liquidity. Accordingly, we intend to reduce our drilling expenditures in 1999 and marshal our resources in order to reduce our indebtedness and to increase our financial flexibility. We will also seek to refinance some of our shorter term bank debt with longer term debt as well as look at other alternatives to improve our liquidity. We are fortunate to have a high quality asset base and to have low cost operations

**1998 Cash Margin**  
*Per thousand cubic feet equivalent*  
**\$2.21 Equivalent Price**



in this low price environment. The cash flow that we have been able to generate with our high cash margin properties has been the strength that the Company has had to allow it to get through the current low oil and gas price environment.

We look forward to the challenges that 1999 will bring with continued low prices and the opportunities for growth that may also appear if oil and gas properties become available at attractive acquisition costs. We at the Company want to thank the stockholders for their continued support in these difficult times for our industry.

M. Jay Allison

*Chairman and President*



**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF**

**THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 1998**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File No. 0-16741**

**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)

**5005 LBJ Freeway, Suite 1000, Dallas, Texas 75244**

(Address of principal executive offices including zip code)

**(972) 701-2000**

(Registrant's telephone number and area code)

Securities registered pursuant to Section 12(b) of the Act:

**Common Stock, \$.50 Par Value**  
**Preferred Stock Purchase Rights**  
(Title of class)

**New York Stock Exchange**  
**New York Stock Exchange**  
(Name of exchange on  
which registered)

Securities registered pursuant to Section 12(g) of the Act: **None**

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K. [  ]

As of March 12, 1999, there were 24,350,452 shares of common stock outstanding.

As of March 12, 1999, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$78,000,000.

**DOCUMENTS INCORPORATED BY REFERENCE**

The information required by Part III of this report is incorporated by reference from registrant's definitive proxy statement for its 1999 annual meeting of stockholders (to be filed with the Securities and Exchange Commission not later than April 30, 1999).

# COMSTOCK RESOURCES, INC.

## FORM 10-K

For the Fiscal Year Ended December 31, 1998

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## FORWARD-LOOKING STATEMENTS

All statements other than statements of historical facts included in this report, including without limitation, statements under "Business and Properties" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" regarding budgeted capital expenditures, estimates of oil and natural gas production, the Company's financial position, oil and natural gas reserve estimates, business strategy and other plans and objectives for future operations, are forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. There are numerous uncertainties inherent in estimating quantities of proved oil and natural gas reserves and in projecting future rates of production and timing of development expenditures, including many factors beyond the control of the Company. Reserve engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact way, and the accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. As a result, estimates made by different engineers often vary from one another. In addition, results of drilling, testing and production subsequent to the date of an estimate may justify revisions of such estimate and such revisions, if significant, would change the schedule of any further production and development drilling. Accordingly, reserve estimates are generally different from the quantities of oil and gas that are ultimately recovered. All forward-looking statements in this report are expressly qualified in their entirety by the cautionary statements in this paragraph.

## DEFINITIONS

The following are abbreviations and definitions of terms commonly used in the oil and gas industry and this report. Natural gas equivalents and crude oil equivalents are determined using the ratio of six Mcf to one Bbl.

"**Bbl**" means a barrel of 42 U.S. gallons of oil.

"**Bcf**" means one billion cubic feet of natural gas.

"**Bcfe**" means one billion cubic feet of natural gas equivalent.

"**Cash Margin per Mcfe**" means the equivalent price per Mcfe less oil and gas operating expenses per Mcfe and general and administrative expenses per Mcfe.

"**Completion**" means the installation of permanent equipment for the production of oil or gas.

"**Condensate**" means a hydrocarbon mixture that becomes liquid and separates from natural gas when the gas is produced and is similar to crude oil.

"**Development well**" means a well drilled within the proved area of an oil or gas reservoir to the depth of a stratigraphic horizon known to be productive.

"**Dry hole**" means a well found to be incapable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of such production exceed production expenses and taxes.

"**Exploratory well**" means a well drilled to find and produce oil or natural gas reserves not classified as proved, to find a new productive reservoir in a field previously found to be productive of oil or natural gas in another reservoir or to extend a known reservoir.

"**Gross**" when used with respect to acres or wells, production or reserves refers to the total acres or wells in which the Company or other specified person has a working interest.

"**MBbls**" means one thousand barrels of oil.

"**MMBbls**" means one million barrels of oil.

"**Mcf**" means one thousand cubic feet of natural gas.

"**Mcfe**" means thousand cubic feet of natural gas equivalent.

"**MMcf**" means one million cubic feet of natural gas.

"**MMcfe**" means one million cubic feet of natural gas equivalent.

"**Net**" when used with respect to acres or wells, refers to gross acres of wells multiplied, in each case, by the percentage working interest owned by the Company.

"**Net production**" means production that is owned by the Company less royalties and production due others.

"**Oil**" means crude oil or condensate.

"**Operator**" means the individual or company responsible for the exploration, development, and production of an oil or gas well or lease.

"**Present Value of Proved Reserves**" means the present value of estimated future revenues to be generated from the production of proved reserves calculated in accordance with the Securities and Exchange Commission guidelines, net of estimated production and future development costs, using prices and costs as of the date of estimation without future escalation, without giving effect to non-property related expenses such as general and administrative expenses, debt service, future income tax expense and depreciation, depletion and amortization, and discounted using an annual discount rate of 10%.

"**Proved developed reserves**" means reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery will be included as "proved developed reserves" only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.

"**Proved reserves**" means the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

(i) Reservoirs are considered proved if economic producibility is supported by either actual production or conclusive formation tests. The area of a reservoir considered proved includes (A) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any; and (B) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of hydrocarbons controls the lower proved limit of the reservoir.



(ii) Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are included in the "proved" classification when successful testing by a pilot project, or the operation of an installed program in the reservoir, provides support for the engineering analysis on which the project or program was based.

(iii) Estimates of proved reserves do not include the following: (A) oil that may become available from known reservoirs but is classified separately as "indicated additional reserves"; (B) crude oil, natural gas, and natural gas liquids, the recovery of which is subject to reasonable doubt because of uncertainty as to geology, reservoir characteristics, or economic factors; (C) crude oil, natural gas, and natural gas liquids, that may occur in undrilled prospects; and (D) crude oil, natural gas, and natural gas liquids, that may be recovered from oil shales, coal, gilsonite and other such resources.

**"Proved undeveloped reserves"** means reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage shall be limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Under no circumstances should estimates for proved undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual tests in the area and in the same reservoir.

**"Recompletion"** means the completion for production of an existing well bore in another formation from that in which the well has been previously completed.

**"Reserve life"** means the calculation derived by dividing year-end reserves by total production in that year.

**"Reserve replacement"** means the calculation derived by dividing additions to reserves from acquisitions, extensions, discoveries and revisions of previous estimates in a year by total production in that year.

**"Royalty"** means an interest in an oil and gas lease that gives the owner of the interest the right to receive a portion of the production from the leased acreage (or of the proceeds of the sale thereof), but generally does not require the owner to pay any portion of the cost of drilling or operating the wells on the leased acreage. Royalties may be either landowner's royalties, which are reserved by the owner of the leased acreage at the time the lease is granted, or overriding royalties, which are usually reserved by an owner of the leasehold in connection with a transfer to a subsequent owner.

**"3-D seismic"** means an advanced technology method of detecting accumulations of hydrocarbons identified by the collection and measurement of the intensity and timing of sound waves transmitted into the earth as they reflect back to the surface.

**"Working interest"** means an interest in an oil and gas lease that gives the owner of the interest the right to drill for and produce oil and gas on the leased acreage and requires the owner to pay a share of the costs of drilling and production operations. The share of production to which a working interest owner is entitled will always be smaller than the share of costs that the working interest owner is required to bear, with the balance of the production accruing to the owners of royalties. For example, the owner of a 100% working interest in a lease burdened only by a landowner's royalty of 12.5% would be required to pay 100% of the costs of a well but would be entitled to retain 87.5% of the production.

**"Workover"** means operations on a producing well to restore or increase production.

## PART I

### ITEMS 1. AND 2. BUSINESS AND PROPERTIES

Comstock Resources, Inc. (together with its subsidiaries, the "Company" or "Comstock") is an independent energy company engaged in the acquisition, development, production and exploration of oil and natural gas properties. The Company has an oil and natural gas reserve base which is entirely focused in the Gulf of Mexico, Southeast Texas and East Texas/ North Louisiana regions. Approximately 43% of the Company's oil and natural gas reserves are located in the Gulf of Mexico, 26% in Southeast Texas and 31% in East Texas/ North Louisiana. Due to this focus, Comstock has accumulated significant geologic knowledge, technical expertise and industry relationships in these regions. Additionally, the Company has significant operating control over its properties and operates 83% of its Present Value of Proved Reserves as of December 31, 1998. Comstock has compiled a high quality reserve base that is 67% natural gas and 76% proved developed on a Bcfe basis. The Company has estimated proved oil and natural gas reserves of 371.9 Bcfe with an estimated Present Value of Proved Reserves of \$305.3 million as of December 31, 1998.

Comstock has achieved substantial growth in oil and gas reserves, production and revenues over the last five years. The Company's estimated proved oil and natural gas reserves have increased at a compounded annual growth rate of 32% from 123.6 Bcfe at the end of 1994 to 371.9 Bcfe at the end of 1998. Average net daily production has increased at a compounded annual growth rate of 51% from 22.2 MMcfe per day in 1994 to 115.5 MMcfe per day in 1998. The Company's oil and gas revenues have increased from \$16.9 million in 1994 to \$93.0 million in 1998.

While its historical growth has been primarily attributable to acquisitions, during 1998 Comstock has focused on the exploitation and development of its properties through development drilling, workovers, recompletions and exploration. The Company believes it has a significant inventory of development and exploration prospects and increased its spending on exploration and development activities from \$2.1 million in 1994 to \$64.6 million in 1998. In 1998, Comstock drilled 30 development wells (18.2 net) of which 25 were successful (14.7 net) and 14 exploratory wells (7.2 net) of which eight were successful (4.3 net).

Over the past five years, the Company has been able to lower lifting costs and general and administrative expenses per unit of production, concurrent with increases in production, through strict control over operations and costs. Comstock's lifting costs per Mcfe have decreased from \$0.75 in 1994 to \$0.59 in 1998. Comstock's general and administrative expenses per Mcfe have decreased from \$0.19 in 1994 to \$0.04 in 1998. Operated wells represent 83% of the Company's Present Value of Proved Reserves as of December 31, 1998, which enables Comstock to effectively control costs and expenses and the timing and method of exploration and development of its properties. Additionally, Comstock's geographic focus allows it to manage its asset base with a relatively small number of employees.

#### **Business Strategy**

The Company's strategy is to increase cash flow and net asset value by exploiting its reserves, pursuing selective exploration opportunities, maintaining a low cost structure and acquiring oil and gas properties at attractive costs.

##### *Exploit Existing Reserves*

The Company seeks to maximize the value of its properties by increasing production and recoverable reserves through active workover, recompletion and exploitation activities. The Company utilizes advanced industry technology, including 3-D seismic data, improved logging tools and formation stimulation techniques.

During 1998, the Company spent \$20.4 million to drill 30 development wells (18.2 net), of which 25 wells (14.7 net) were successful, representing a success rate of 83%. In addition, the Company spent approximately \$10.2 million for recompletion and workover activity during 1998. The Company has budgeted up to \$26.0 million in 1999 for development drilling and installation of production facilities. Comstock's level of spending on development drilling in 1999 will be principally dependent on improvement to existing oil and gas prices.

#### *Pursue Selective Exploration Opportunities*

The Company pursues selective exploration activities to find additional reserves on its undeveloped acreage. In 1998, the Company spent approximately \$30.4 million to drill 14 exploratory wells (7.2 net), of which eight wells (4.3 net) were successful, representing a success rate of 53%. The Company has budgeted up to \$10.0 million in 1999 for exploration activities which will be focused on the Gulf of Mexico region and based on drilling 3-D seismic generated prospects. These prospects include those acquired from Bois d' Arc Resources and certain of its affiliates and working interest partners, and those prospects generated under the joint exploration program with Bois d' Arc Resources and its principals ("Bois d' Arc") entered into in December 1997 under which the Company and Bois d' Arc jointly explore for prospects in the Gulf of Mexico Region (the "Bois d' Arc Exploration Venture"). Under the Bois d' Arc Exploration Venture, Bois d' Arc is responsible for identifying potential prospects and the parties jointly acquire 3-D seismic data and leasehold acreage, the costs for which are shared 80% by the Company and 20% by Bois d' Arc. With respect to any prospect in which the Company elects to participate in drilling, the Company acquires up to 33% working interest and recovers any disproportionate seismic and leasehold costs previously incurred. The Company issued to Bois d' Arc warrants to acquire up to 1,000,000 shares of the Company's common stock at an exercise price of \$14.00 per share as part of the venture. The warrants vest in 50,000 share increments based on the success of an initial test well on a prospect.

#### *Maintain Low Cost Structure*

The Company seeks to increase cash flow by carefully controlling operating costs and general and administrative expenses. The Company targets acquisitions that possess, among other characteristics, low per unit operating costs. In addition, the Company has been able to reduce per unit operating costs by eliminating unnecessary field and corporate overhead costs and by divesting properties that have high lifting costs with little future development potential. Through these efforts, the Company's general and administrative expenses and average oil and gas operating costs per Mcfe have decreased from \$0.19 and \$0.75, respectively, in 1994 to \$0.04 and \$0.59, respectively, in 1998.

In addition, the Company prefers to operate the properties it acquires, allowing it to further control operating costs, exercise greater control over the timing and plans for future development, the level of drilling and lifting costs, and the marketing of production. The Company operates 366 of the 580 wells in which it owns an interest which comprise approximately 83% of its Present Value of Proved Reserves as of December 31, 1998.

#### *Acquire High Quality Properties at Attractive Costs*

The Company has a successful track record of increasing its oil and natural gas reserves through opportunistic acquisitions. Since 1991, Comstock has added 482.4 Bcfe of proved oil and natural gas reserves from 18 acquisitions at a total cost of \$411.9 million, or \$0.85 per Mcfe. The acquisitions were acquired at 63% of their Present Value of Proved Reserves in the year the acquisitions were completed. The Company's three largest acquisitions to date have been its acquisition of offshore Gulf of Mexico properties from Bois d' Arc and certain of its affiliates and working interest partners in December 1997 for \$200.9 million (the "Bois d'Arc Acquisition"), its acquisition of Black Stone Oil Company and interests in the Double A Wells field in Southeast Texas in May 1996 for \$100.4 million (the "Black Stone Acquisition") and its purchase of properties from Sonat Inc. in July 1995 for \$48.1 million (the "Sonat Acquisition"). The Company applies strict



economic and reserve risk criteria in evaluating acquisitions and targets properties in its core operating areas with established production and low operating costs that also have potential opportunities to increase production and reserves through exploration and exploitation activities.

### Primary Operating Areas

The Company's activities are concentrated in three primary operating areas: Gulf of Mexico, Southeast Texas, and East Texas/ North Louisiana. The following table summarizes the Company's estimated proved oil and natural gas reserves by field as of December 31, 1998.

<u>Field Area</u>	<u>Net Oil (MBbls)</u>	<u>Net Gas (MMcf)</u>	<u>MMcfe</u>	<u>Present Value of Proved Reserves (In thousands)</u>	<u>Percentage</u>
<b>Gulf of Mexico</b>					
Ship Shoal .....	11,344	35,935	104,000	\$ 99,803	
South Timbalier/ South Pelto .	1,191	4,583	11,728	10,580	
Bay Marchand .....	1,062	1,689	8,064	7,725	
West Cameron .....	1	5,638	5,643	5,380	
Main Pass .....	1,831	2,309	13,295	4,869	
East White Point .....	814	3,512	8,393	3,704	
El Campo .....	241	3,394	4,842	3,214	
Other .....	75	3,086	3,538	2,447	
	<u>16,559</u>	<u>60,146</u>	<u>159,503</u>	<u>137,722</u>	45.1%
<b>Southeast Texas</b>					
Double A Wells .....	2,836	76,954	93,968	86,925	
Redmond Creek .....	124	1,522	2,267	1,861	
	<u>2,960</u>	<u>78,476</u>	<u>96,235</u>	<u>88,786</u>	29.1%
<b>East Texas/ North Louisiana</b>					
Beckville .....	117	27,387	28,089	17,611	
Logansport .....	52	22,133	22,442	17,103	
Waskom .....	239	13,457	14,893	7,133	
Box Church .....	3	11,855	11,870	6,975	
Lisbon .....	80	6,095	6,574	6,330	
Blocker .....	43	9,977	10,234	5,553	
Ada .....	9	3,934	3,988	4,657	
Longwood .....	40	5,542	5,779	3,543	
Sugar Creek .....	65	2,980	3,371	3,237	
Sligo .....	13	2,223	2,299	1,673	
Simsboro .....	3	2,266	2,282	1,387	
Other .....	45	3,419	3,699	3,080	
	<u>709</u>	<u>111,268</u>	<u>115,520</u>	<u>78,282</u>	25.6%
<b>Other Areas</b> .....	<u>17</u>	<u>512</u>	<u>614</u>	<u>519</u>	.2%
<b>Total</b> .....	<u>20,245</u>	<u>250,402</u>	<u>371,872</u>	<u>\$ 305,309</u>	<u>100.0%</u>

### Gulf of Mexico

The Company's largest operating region includes properties located offshore of Louisiana in state and federal waters of the Gulf of Mexico, and in fields along the Texas and Louisiana Gulf Coast. The Company owns interests in 121 producing wells (71.1 net) in 11 field areas, the largest of which are the Ship Shoal area (Ship Shoal Blocks 66, 67, 68, 69 and South Pelto Block 1), the Main Pass area (Main Pass Blocks 21 and 25), Bay Marchand Blocks 4 and 5 and the South Timbalier/ South Pelto area (South Timbalier Blocks 11,16, 34, 50 and South Pelto Blocks 5 and 15.) The Company has 159.5 Bcfe of oil and natural gas reserves in the Gulf of Mexico region with a Present Value of Proved Reserves of \$137.7 million as of December 31, 1998. The Company operates 47 of the wells (46.1 net) that it owns in this region. The Company acquired a large percentage of its reserves in the region in the Bois d' Arc Acquisition. Production from the region averaged 17.5 MMcf of natural gas per day and 5,229 barrels of oil per day during 1998. The Company spent \$35.7

million in this region in 1998 to drill two development wells (1.4 net) and to drill 13 exploratory wells (6.7 net). In 1999, the Company plans to spend \$2.0 million for production facilities at Bay Marchand and South Timbalier/ South Pelto and up to \$12.0 million for development drilling and up to \$10.0 million for exploration activities in this region.

#### *Ship Shoal*

The Ship Shoal area is located in Louisiana state waters and in federal waters, offshore of Terrebonne Parish and near the state/federal waters boundary. The Company became the operator of its properties in this area as a result of the Bois d' Arc Acquisition and owns a 99% to 100% working interest and operates these properties except for its properties in Ship Shoal Block 69 in which the Company has a 25% working interest. In the Ship Shoal area, oil and natural gas are produced from numerous Miocene sands occurring at depths from 5,800 feet to 13,500 feet, and in water depths from 10 to 40 feet. The Company's Ship Shoal area has estimated proved reserves of 104.0 Bcfe (28% of total proved reserves) with a Present Value of Proved Reserves of \$99.8 million as of December 31, 1998. The Company owns interests in 33 wells (23.9 net) in the Ship Shoal area, which averaged 12.8 MMcf of natural gas per day and 4,342 barrels of oil per day during 1998.

In 1998 the Company drilled five wells (5.0 net), four exploratory wells and one development well in the Ship Shoal area. Three of the exploration wells were successful and one was a dry hole. The three successful wells were placed on production in November and December 1998. The Company has temporarily abandoned the development well as it was unable to successfully complete it.

#### *South Timbalier/ South Pelto*

The Company owns working interests ranging from 25% to 33% in Louisiana state waters and in federal waters in the South Timbalier/ South Pelto area located offshore of Terrebonne and Lafourche Parishes in water depths ranging from 20 to 60 feet. Oil and natural gas are produced from numerous sands of Pliocene to Upper Miocene age, at depths ranging from 2,000 to 12,000 feet. The Company has drilled three successful wells in the area since beginning its exploration program with Bois d' Arc in 1998. These wells should be placed on production from common facilities which are expected to be completed by mid-year 1999. The Company also acquired a 33% working interest in seven producing wells as well as production facilities in this area in 1998. The Company has identified six exploration prospects and one proved undeveloped location in this area using 3-D seismic, targeting the Upper Miocene sands occurring at depths from 10,000 to 12,000 feet. The Company has estimated proved net reserves totaling 11.7 Bcfe (3% of total proved reserves) in this area as of December 31, 1998.

#### *Bay Marchand*

The Company owns a 22.5% working interest in Louisiana state leases in the Bay Marchand area, located offshore of Lafourche Parish in 12 feet of water. The Company has drilled three successful wells in its exploration program with Bois d' Arc since its inception in early 1998. The Company has estimated proved net reserves totaling 8.1 Bcfe (2% of total proved reserves) at Bay Marchand as of December 31, 1998. Production from these wells should begin in the second quarter of 1999 pending the acquisition of production facilities for the new wells. The properties are located on the west flank of the Bay Marchand salt dome in a highly prolific oil and natural gas producing region. Producing zones in this area are Upper to Middle Miocene in age, highly porous and permeable, and occur at depths ranging from 9,000 to 14,500 feet. The Company has identified three additional exploration prospects in this area, using 3-D seismic data.

## **Southeast Texas**

Approximately 26% (96.2 Bcfe) of the Company's proved reserves are located in Southeast Texas where the Company owns interests in 32 producing wells (12.2 net) and operates 24 of these wells. Reserves in Southeast Texas represent 29% of the Company's Present Value of Proved Reserves as of December 31, 1998. Production rates from the area averaged 28.3 MMcf of natural gas per day and 1,532 barrels of oil per day during 1998.

Substantially all of the reserves in this region are in the Double A Wells field area in Polk County, Texas. The Double A Wells field is the Company's second largest field area with total estimated proved reserves of 94.0 Bcfe (25% of total proved reserves) which have a Present Value of Proved Reserves of \$86.9 million as of December 31, 1998. The Company acquired its interests in the Double A Wells field in May 1996 in the Black Stone Acquisition. Net daily production averaged 1,463 barrels of oil per day and 27.4 MMcf of natural gas during 1998. These wells typically produce from the Woodbine formation at an average depth of 14,300 feet. The Company has an average working interest in this area of 37% and its leasehold position at December 31, 1998 consisted of 21,225 acres (7,863 net). During 1998, the Company successfully recompleted two wells in this field and is in the process of acquiring 3-D seismic data on 25,000 acres in this area. The Company has budgeted \$2.5 million to drill two development wells (0.6 net) in the Double A Wells field in 1999.

## **East Texas/ North Louisiana**

Approximately 31% (115.5 Bcfe) of the Company's proved reserves are located in East Texas and North Louisiana where the Company owns interests in 401 producing wells (225.2 net) in 18 field areas and operates 276 of these wells (199.5 net). The largest of the Company's field areas in this region are the Beckville, Logansport, Waskom and Box Church fields. Reserves in the region represented 26% of the Company's Present Value of Proved Reserves as of December 31, 1998. Production from this region averaged 27.1 MMcf of natural gas per day and 246 barrels of oil per day during 1998. The Company's largest acquisition in this region was the Sonat Acquisition in July 1995. Since this acquisition, the Company has focused on increasing production through infill drilling and recompletions. Most of the reserves in this area produce from the Cretaceous aged Travis Peak/Hosston formation and the Jurassic aged Cotton Valley formation. The total thickness of these formations range from 2,000 feet to 4,000 feet of sand and shale sequences in the East Texas Basin and the North Louisiana Salt Basin, at depths ranging from 6,000 feet to 10,500 feet. The Company believes that success in these formations can be enhanced by applying new hydraulic fracturing and completion techniques, magnetic resonance imaging (MRI) logging tools and infill drilling. In 1998 the Company spent \$14.5 million to drill 29 wells (17.3 net) and plans to spend up to \$9.5 million in 1999 to drill 16 development wells (10.5 net).

### *Beckville*

The Company's properties in the Beckville field, located in Panola County, Texas, represented approximately 8% (28.1 Bcfe) of the Company's proved reserves as of December 31, 1998. The Company operates 54 wells in this field and owns interests in seven additional wells. The Company has an average working interest of 72% in this field. During 1998, the production attributable to the Company's interest from this field averaged 4.3 MMcf of natural gas and 23 barrels of oil per day. The Beckville field produces from the Cotton Valley formation at depths ranging from 9,000 to 10,000 feet. The Company drilled nine wells (6.2 net) in 1998 at a cost of \$6.2 million and has budgeted up to \$4.5 million to drill six development wells (4.6 net) in 1999.



### *Logansport*

The Logansport field produces from multiple pay zones in the Hosston formation at an average depth of 8,000 feet and is located in DeSoto Parish, Louisiana. The Company's proved reserves of 22.4 Bcfe in the Logansport field represented approximately 6% of the Company's proved reserves as of December 31, 1998. The Company operates 72 wells in this field and owns interests in 32 additional wells. The Company's average working interest in this field is 50%. During 1998, production attributable to the Company's interest averaged 7.1 MMcf of natural gas and 28 barrels of oil per day. The Company spent \$3.4 million to drill nine wells (4.4 net) during 1998 and has budgeted up to \$2.0 million to drill six development wells in 1999 (3.2 net).

### *Waskom*

The Waskom field, located in Harrison and Panola Counties in Texas, represented approximately 4% (14.9 Bcfe) of the Company's proved reserves as of December 31, 1998. The Company operates 58 wells in this field and owns interests in 38 additional wells. The Company's average working interest in this field is 49%. During 1998, production attributable to the Company's interest averaged 2.3 MMcf of natural gas and 32 barrels of oil per day. The Waskom field produces from the Cotton Valley formation at depths ranging from 9,000 to 10,000 feet.

### *Box Church*

The Company's properties in the Box Church field, located in Limestone County, Texas, represented approximately 3% (11.9 Bcfe) of the Company's proved reserves as of December 31, 1998. The Company operates nine wells in this field with an average working interest of 86%. During 1998, production attributable to the Company's interest from this field averaged 1.3 MMcf of natural gas and 2 barrels of oil per day. The Box Church field produces from the Cotton Valley formation at depths ranging from 10,200 to 10,500 feet. The Company drilled three wells (3.7 net) in 1998 at a cost of \$2.4 million and has budgeted up to \$1.6 million to drill two development wells (1.9 net) in 1999.

## **Acquisition Activities**

### *Acquisition Strategy*

The Company has concentrated its acquisition activity in the Gulf of Mexico, Southeast Texas and East Texas/ North Louisiana regions. Using a strategy that capitalizes on management's strong knowledge of and experience in these regions, the Company seeks to selectively pursue acquisition opportunities where the Company can evaluate the assets to be acquired in detail prior to completion of the transaction. The Company evaluates a large number of prospective properties according to certain internal criteria, including established production and the properties' future development and exploration potential, low operating costs and the ability for the Company to obtain operating control. The Company believes that due to the current environment of depressed commodity prices, the industry will continue to consolidate as companies look to divest oil and gas properties. As a result, the Company may have opportunities to make acquisitions at favorable prices, including attractive acquisitions outside its core operating areas.

### Major Property Acquisitions

As a result of its acquisitions, the Company has added 482.4 Bcfe of proved oil and natural gas reserves since 1991 as summarized in the following table:

<u>Year</u>	<u>Acquisition Cost (000's)</u>	<u>Proved Reserves When Acquired(1)</u>			<u>Acquisition Cost Per Mcfe(1)</u>	<u>Present Value of Proved Reserves When Acquired (000's)(1)</u>	<u>Acquisition Cost as a Percentage of Present Value of Proved Reserves(1)</u>
		<u>(MBbls)</u>	<u>(MMcf)</u>	<u>(MMcfe)</u>			
1997(2)	\$ 189,904	14,473	39,970	126,808	\$ 1.50	\$ 205,583	92%
1996	100,446	5,930	100,446	136,027	0.74	282,150	36%
1995	56,081	1,859	108,432	119,585	0.47	85,706	65%
1994	12,970	388	12,744	15,074	0.86	14,050	92%
1993	26,928	2,250	28,349	41,848	0.64	33,502	80%
1992	4,730	44	8,821	9,086	0.52	8,474	56%
1991	<u>20,862</u>	<u>689</u>	<u>29,868</u>	<u>34,002</u>	0.61	<u>27,298</u>	76%
Total	<u>\$ 411,921</u>	<u>25,633</u>	<u>328,630</u>	<u>482,430</u>	0.85	<u>\$ 656,763</u>	63%

- (1) Based on reserve estimates and prices at the end of the year in which the acquisition occurred, as adjusted to reflect actual production from the closing date of the respective acquisition to such year end.
- (2) The 1997 Acquisitions exclude acquisition costs allocated to unevaluated properties of \$30.2 million and other assets of \$1.0 million.

In 1998 the Company's only acquisition was a purchase of acreage and production facilities at South Timbalier Blocks 34 and 50 and South Pelto Block 15 located offshore of Louisiana in the Gulf of Mexico.

Of the 18 property acquisitions completed by the Company since 1991, four acquisitions described below account for 83% of the total acquisition cost and total reserves acquired.

**Bois d' Arc Acquisition.** In December 1997, the Company acquired working interests in certain producing offshore Louisiana oil and gas properties as well as interests in undeveloped offshore oil and natural gas leases for approximately \$200.9 million from Bois d' Arc and certain of its affiliates and working interest partners. The Company acquired interests in 43 wells (29.6 net) and eight separate production complexes located in the Gulf of Mexico offshore of Plaquemines and Terrebonne Parishes, Louisiana. The acquisition included interests in the Louisiana state and federal offshore areas of Main Pass Blocks 21 and 25, Ship Shoal Blocks 66, 67, 68 and 69 and South Pelto Block 1. The Company also acquired interests in seven undrilled prospects which were delineated by 3-D seismic data. The net proved reserves acquired were estimated at 14.3 MMBbls of oil and 29.4 Bcf of natural gas. Approximately \$30.2 million of the purchase price was attributed to the undrilled prospects and \$1.0 million was attributed to other assets.

**Black Stone Acquisition.** In May 1996, the Company acquired 100% of the capital stock of Black Stone Oil Company and interests in producing and undeveloped oil and gas properties located in Southeast Texas for \$100.4 million. The Company acquired interests in 19 wells (7.7 net) that are located in the Double A Wells field in Polk County, Texas and is the operator of most of the wells in the field. The net proved reserves acquired were estimated at 5.9 MMBbls of oil and 100.4 Bcf of natural gas.

**Sonat Acquisition.** In July 1995, the Company purchased interests in certain producing oil and gas properties located in East Texas and North Louisiana from Sonat Inc. for \$48.1 million. The Company acquired interests in 319 producing wells (188.0 net). The acquisition included interests in the Beckville, Logansport, Waskom, Blocker, Longwood and Simsboro fields. The net proved reserves acquired were estimated at 0.8 MMBbls of oil and 104.7 Bcf of natural gas.

**Stanford Acquisition.** In November 1993, the Company acquired Stanford Offshore Energy, Inc. ("Stanford") through a merger with a wholly owned subsidiary. The Stanford stockholders were issued an aggregate of 1,760,000 shares of common stock of the Company in the merger with a total value of \$6.2 million and the Company assumed approximately \$16.5 million of indebtedness of Stanford. Stanford had interests in 107 producing wells (58.8 net) located primarily in the Gulf of Mexico region. Major properties acquired include West Cameron Blocks 238, 248 and 249, the East White Point field and the Redmond Creek field. The net proved reserves acquired were estimated at 1.0 MMBbls of oil and 17.8 Bcf of natural gas.

## Oil and Natural Gas Reserves

The following table sets forth the estimated proved oil and natural gas reserves of the Company and the Present Value of Proved Reserves as of December 31, 1998:

<b>Category</b>	<b>Oil (MBbls)</b>	<b>Gas (Mmcf)</b>	<b>Total (Mmcf)</b>	<b>Present Value of Proved Reserves (000's)</b>
Proved Developed Producing	9,800	132,613	191,414	\$ 176,780
Proved Developed Non-producing	6,785	50,342	91,053	72,436
Proved Undeveloped	<u>3,660</u>	<u>67,447</u>	<u>89,405</u>	<u>56,093</u>
Total Proved	<u>20,245</u>	<u>250,402</u>	<u>371,872</u>	<u>\$ 305,309</u>

There are numerous uncertainties inherent in estimating oil and natural gas reserves and their values, including many factors beyond the control of the producer. The reserve data set forth above represents estimates only. Reserve engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact manner. The accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. As a result, estimates of different engineers may vary. In addition, estimates of reserves are subject to revision based on the results of drilling, testing and production subsequent to the date of such estimate. Accordingly, reserve estimates are often different from the quantities of oil and gas reserves that are ultimately recovered.

In general, the volume of production from oil and natural gas properties declines as reserves are depleted. Except to the extent the Company acquires properties containing proved reserves or conducts successful exploration and development activities, the proved reserves of the Company will decline as reserves are produced. The Company's future oil and natural gas production is, therefore, highly dependent upon its level of success in acquiring or finding additional reserves.

The Company's average price received for crude oil production on December 31, 1997 was \$17.24 per Bbl. This price declined to \$10.55 per Bbl on December 31, 1998. The Company's average price received for natural gas production on December 31, 1997 was \$2.64 per Mcf. This price declined to \$2.21 per Mcf on December 31, 1998. Further declines in the price of crude oil or natural gas could have an adverse effect on the Company's Present Value of Proved Reserves, which in turn could adversely affect borrowing capacity and the Company's ability to obtain additional capital and the Company's financial condition, revenues, profitability and cash flows from operations.



## Drilling Activity Summary

During the three-year period ended December 31, 1998, the Company drilled development and exploratory wells as set forth in the table below.

	Year Ended December 31,					
	1996		1997		1998	
	Gross	Net	Gross	Net	Gross	Net
Development Wells:						
Oil	2	1.0	2	0.6	-	-
Gas	16	8.4	31	16.1	25	14.7
Dry	<u>1</u>	<u>1.0</u>	<u>7</u>	<u>2.3</u>	<u>5</u>	<u>3.5</u>
	<u>19</u>	<u>10.4</u>	<u>40</u>	<u>19.0</u>	<u>30</u>	<u>18.2</u>
Exploratory Wells:						
Oil	-	-	1	0.3	6	2.3
Gas	-	-	4	1.3	2	2.0
Dry	<u>1</u>	<u>0.2</u>	<u>4</u>	<u>1.6</u>	<u>6</u>	<u>2.9</u>
	<u>1</u>	<u>0.2</u>	<u>9</u>	<u>3.2</u>	<u>14</u>	<u>7.2</u>
Total Wells	<u>20</u>	<u>10.6</u>	<u>49</u>	<u>22.2</u>	<u>44</u>	<u>25.4</u>

As of December 31, 1998, the Company was drilling one exploratory well (0.2 net) which subsequently resulted in a successful discovery.

## Producing Well Summary

The following table sets forth the gross and net producing oil and natural gas wells in which the Company owned an interest at December 31, 1998.

	Oil		Gas	
	Gross	Net	Gross	Net
Texas	17	10.7	277	149.5
Louisiana	9	5.7	204	99.2
State and Federal Offshore	32	23.9	38	22.3
Mississippi	<u>1</u>	<u>0.1</u>	<u>2</u>	<u>0.3</u>
Total wells	<u>59</u>	<u>40.4</u>	<u>521</u>	<u>271.3</u>

The Company operates 366 of the 580 producing wells presented in the above table.

## Acreage

The following table summarizes the Company's developed and undeveloped leasehold acreage at December 31, 1998. Excluded is acreage in which the Company's interest is limited to royalty or similar interests.

	Developed		Undeveloped	
	Gross	Net	Gross	Net
Texas	164,529	118,471	37,102	15,876
Louisiana	78,812	58,381	1,896	1,123
State and Federal Offshore	34,056	14,619	870	870
Mississippi	<u>1,360</u>	<u>210</u>	<u>-</u>	<u>-</u>
Total	<u>278,757</u>	<u>191,681</u>	<u>39,868</u>	<u>17,869</u>

Title to the Company's oil and natural gas properties is subject to royalty, overriding royalty, carried and other similar interests and contractual arrangements customary in the oil and gas industry, liens incident to operating agreements, current taxes not yet due, and other minor encumbrances. All of the Company's oil and natural gas properties are pledged as collateral under the Company's bank credit facility. As is customary in the oil and gas industry, the Company is generally able to retain its ownership interest in undeveloped acreage by production of existing wells, by drilling activity which establishes commercial reserves sufficient to maintain the lease or by payment of delay rentals.

## **Markets and Customers**

The market for oil and natural gas produced by the Company depends on factors beyond its control, including the extent of domestic production and imports of oil and natural gas, the proximity and capacity of natural gas pipelines and other transportation facilities, demand for oil and natural gas, the marketing of competitive fuels and the effects of state and federal regulation. The oil and gas industry also competes with other industries in supplying the energy and fuel requirements of industrial, commercial and individual consumers.

Substantially all of the Company's natural gas production is sold either on the spot natural gas market on a month-to-month basis at prevailing spot market prices or under long-term contracts based on current spot market gas prices. A portion of the natural gas production from the Company's Double A Wells field is sold under a long-term contract to Houston Pipeline Company, a subsidiary of Enron Corporation ("HPL"). The agreement with HPL expires on October 31, 2000 with pricing based on a percentage of spot gas prices for natural gas delivered to the Houston Ship Channel. Total gas sales in 1998 to HPL accounted for approximately 17% of the Company's 1998 oil and gas sales. Gas production from the Company's offshore properties at the Ship Shoal and Main Pass areas, which represented 12% of the Company's 1998 oil and gas sales, is sold under a short-term contract based on spot market gas prices to H & N Gas, Ltd.

All of the Company's oil production is sold at the well site at posted field prices tied to the spot oil markets. Sales of oil production from the Company's Ship Shoal and Main Pass offshore properties to Gulfmark Energy, Inc, accounted for 25% of the Company's 1998 oil and gas sales.

## **Competition**

The oil and gas industry is highly competitive. Competitors include major oil companies, other independent energy companies, and individual producers and operators, many of which have financial resources, personnel and facilities substantially greater than those of the Company. The Company faces intense competition for the acquisition of oil and natural gas properties.

## **Regulation**

The Company's operations are regulated by certain federal and state agencies. In particular, oil and natural gas production and related operations are or have been subject to price controls, taxes and other laws relating to the oil and natural gas industry. The Company cannot predict how existing laws and regulations may be interpreted by enforcement agencies or court rulings, whether additional laws and regulations will be adopted, or the effect such changes may have on its business or financial condition.

Sales of natural gas by the Company are not regulated and are made at market prices. However, the Federal Energy Regulatory Commission ("FERC") regulates interstate and certain intrastate natural gas transportation rates and service conditions, which affect the marketing of natural gas produced by the Company, as well as the revenues received by the Company for sales of such production. Since the mid-

1980s, FERC has issued a series of orders, culminating in Order Nos. 636, 636-A and 636-B ("Order 636"), that have significantly altered the marketing and transportation of gas. Order 636 mandated a fundamental restructuring of interstate pipeline sales and transportation service, including the unbundling by interstate pipelines of the sales, transportation, storage and other components of the city-gate sales services such pipelines previously performed. One of FERC's purposes in issuing the orders was to increase competition within all phases of the natural gas industry. Generally, Order 636 has eliminated or substantially reduced the interstate pipelines' traditional role as wholesalers of natural gas, and has substantially increased competition and volatility in natural gas markets.

Sales of oil and natural gas liquids by the Company are not regulated and are made at market prices. The price the Company receives from the sale of these products is affected by the cost of transporting the products to market.

The Company's oil and natural gas exploration, production and related operations are subject to extensive rules and regulations promulgated by federal, state and local agencies. Failure to comply with such rules and regulations can result in substantial penalties. The regulatory burden on the oil and gas industry increases the Company's cost of doing business and affects its profitability. Because such rules and regulations are frequently amended or reinterpreted, the Company is unable to predict the future cost or impact of complying with such laws.

The states of Texas and Louisiana require permits for drilling operations, drilling bonds and the filing of reports concerning operations and impose other requirements relating to the exploration and production of oil and gas. These states also have statutes or regulations addressing conservation matters, including provisions for the unitization or pooling of oil and natural gas properties, the establishment of maximum rates of production from oil and gas wells and the regulation of spacing, plugging and abandonment of such wells. The statutes and regulations of certain states limit the rate at which oil and gas can be produced from the Company's properties.

The Company is required to comply with various federal and state regulations regarding plugging and abandonment of oil and natural gas wells. The Company provides reserves for the estimated costs of plugging and abandoning its wells, to the extent such costs exceed the estimated salvage value of the wells, on a unit of production basis.

#### *Environmental*

Various federal, state and local laws and regulations governing the discharge of materials into the environment, or otherwise relating to the protection of the environment, health and safety, affect the Company's operations and costs. These laws and regulations sometimes require governmental authorization before conducting certain activities, limit or prohibit other activities because of protected areas or species, create the possibility of substantial liabilities for pollution related to Company operations or properties, and provide penalties for noncompliance. In particular, the Company's drilling and production operations, its activities in connection with storage and transportation of crude oil and other liquid hydrocarbons, and its use of facilities for treating, processing or otherwise handling hydrocarbons and related exploration and production wastes are subject to stringent environmental regulation. As with the industry in general, compliance with existing and anticipated regulations increases the Company's overall cost of business. While these regulations affect the Company's capital expenditures and earnings, the Company believes that such regulations do not affect its competitive position in the industry because its competitors are similarly affected by environmental regulatory programs. Environmental regulations have historically been subject to frequent change and, therefore, the Company cannot predict with certainty the future costs or other future impacts of environmental regulations on its future operations. A discharge of hydrocarbons or hazardous substances into the



environment could subject the Company to substantial expense, including the cost to comply with applicable regulations that require a response to the discharge, such as containment or cleanup, claims by neighboring landowners or other third parties for personal injury, property damage or their response costs and penalties assessed, or other claims sought, by regulatory agencies for response cost or for natural resource damages.

The following are examples of some environmental laws that potentially impact the Company and its operations.

**Water.** The Oil Pollution Act ("OPA") was enacted in 1990 and amends provisions of the Federal Water Pollution Control Act of 1972 ("FWPCA") and other statutes as they pertain to the prevention of and response to major oil spills. The OPA subjects owners of facilities to strict, joint and potentially unlimited liability for removal costs and certain other consequences of an oil spill along shorelines or that enters navigable waters. In the event of an oil spill into such waters, substantial liabilities could be imposed upon the Company. Recent regulations developed under OPA require companies that own offshore facilities, including the Company, to demonstrate oil spill financial responsibility for removal costs and damage caused by oil discharge. States in which the Company operates have also enacted similar laws. Regulations are currently being developed under the OPA and similar state laws that may also impose additional regulatory burdens on the Company.

The FWPCA imposes restrictions and strict controls regarding the discharge of produced waters, other oil and gas wastes, any form of pollutant, and, in some instances, storm water runoff, into waters of the United States. The FWPCA provides for civil, criminal and administrative penalties for any unauthorized discharges and, along with the OPA, imposes substantial potential liability for the costs of removal, remediation or damages resulting from an unauthorized discharge. State laws for the control of water pollution also provide civil, criminal and administrative penalties and liabilities in the case of an unauthorized discharge into state waters. The cost of compliance with the OPA and the FWPCA have not historically been material to the Company's operations, but there can be no assurance that changes in federal, state or local water pollution control programs will not materially adversely affect the Company in the future. Although no assurances can be given, the Company believes that compliance with existing permits and compliance with foreseeable new permit requirements will not have a material adverse effect on the Company's financial condition or results of operations.

**Air Emissions.** Amendments to the Federal Clean Air Act enacted in 1990 (the "1990 CAA Amendments") require or will require most industrial operations in the United States to incur capital expenditures in order to meet air emissions control standards developed by the United States Environmental Protection Agency ("EPA") and state environmental agencies. The 1990 CAA Amendments impose a new operating permit on major sources, and several of the Company's facilities may require permits under this new program. Although no assurances can be given, the Company believes implementation of the 1990 CAA Amendments will not have a material adverse effect on the Company's financial condition or results of operations.

**Solid Waste.** The Company generates non-hazardous solid wastes that are subject to the requirements of the Federal Resource Conservation and Recovery Act ("RCRA") and comparable state statutes. The EPA and the states in which the Company operates are considering the adoption of stricter disposal standards for the type of non-hazardous wastes generated by the Company. RCRA also governs the generation, management, and disposal of hazardous wastes. At present, the Company is not required to comply with a substantial portion of the RCRA requirements because the Company's operations generate minimal quantities of hazardous wastes. However, it is possible that additional wastes, which could include wastes currently generated during the Company's operations, could in the future be designated as "hazardous wastes."

Hazardous wastes are subject to more rigorous and costly disposal and management requirements than are non-hazardous wastes. Such changes in the regulations may result in additional capital expenditures or operating expenses by the Company.

***Superfund.*** The Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), also known as "Superfund", imposes liability, without regard to fault or the legality of the original act, on certain classes of persons in connection with the release of a "hazardous substance" into the environment. These persons include the current owner or operator of any site where a release historically occurred and companies that disposed or arranged for the disposal of the hazardous substances found at the site. CERCLA also authorizes the EPA and, in some instances, third parties to act in response to threats to the public health or the environment and to seek to recover from the responsible classes of persons the costs they incur. In the course of its ordinary operations, the Company may have managed substances that may fall within CERCLA's definition of a "hazardous substance." Therefore, the Company may be jointly and severally liable under CERCLA for all or part of the costs required to clean up sites where the Company disposed of or arranged for the disposal of these substances. This potential liability extends to properties that the Company previously owned or operated, as well as to properties owned and operated by others at which disposal of the Company's hazardous substances occurred.

The Company may also fall into the category of the "current owner or operator." The Company currently owns or leases numerous properties that for many years have been used for the exploration and production of oil and gas. Although the Company believes it has utilized operating and disposal practices that were standard in the industry at the time, hydrocarbons or other wastes may have been disposed of or released by the Company on or under the properties owned or leased by the Company. In addition, many of these properties have been previously owned or operated by third parties who may have disposed of or released hydrocarbons or other wastes at these properties. Under CERCLA and analogous state laws, the Company could be subject to certain liabilities and obligations, such as being required to remove or remediate previously disposed wastes (including wastes disposed of or released by prior owners or operators), to clean up contaminated property (including contaminated groundwater) or to perform remedial plugging operations to prevent future contamination.

### **Office and Operations Facilities**

The Company's executive offices are located at 5005 LBJ Freeway, Suite 1000, Dallas, Texas 75244, and its telephone number is (972) 701-2000.

The Company leases office space in Dallas, Texas. The Dallas lease covers 13,525 square feet at a monthly rate of \$19,682 during 1998. The lease expires on July 31, 1999. In August 1997, the Company entered into a seven year lease covering 20,046 square feet in a building under construction. The Company plans to relocate its corporate headquarters to the building in June 1999. The new lease begins when the space is occupied and is at an initial monthly rate of \$35,081. The Company also owns production offices and pipe yard facilities near Marshall and Livingston, Texas and near Logansport, Louisiana.

### **Employees**

As of December 31, 1998, the Company had 47 employees and utilized contract employees for certain of its field operations. The Company considers its employee relations to be satisfactory.

## Directors, Executive Officers and Other Management

The following table sets forth certain information concerning the executive officers and directors of the Company.

<u>Name</u>	<u>Age</u>	<u>Position with Company</u>
M. Jay Allison .....	43	President, Chief Executive Officer and Chairman of the Board of Directors
Roland O. Burns .....	38	Senior Vice President, Chief Financial Officer, Secretary and Treasurer
Mack D. Good .....	48	Vice President of Operations
Stephen E. Neukom .....	49	Vice President of Marketing
Richard G. Powers .....	44	Vice President of Land
Daniel K. Presley .....	38	Vice President of Accounting and Controller
Michael W. Taylor .....	45	Vice President of Corporate Development
Richard S. Hickok .....	73	Director
Franklin B. Leonard .....	71	Director
Cecil E. Martin, Jr .....	57	Director
David W. Sledge .....	42	Director

### *Executive Officers*

**M. Jay Allison** has been a director of the Company since 1987, and President and Chief Executive Officer of the Company since 1988. Mr. Allison was elected Chairman of the Board of Directors in 1997. From 1987 to 1988, Mr. Allison served as Vice President and Secretary of the Company. From 1981 to 1987, he was a practicing oil and gas attorney with the firm of Lynch, Chappell & Alsup in Midland, Texas. In 1983, Mr. Allison co-founded a private independent oil and gas company, Midwood Petroleum, Inc., which was active in the acquisition and development of oil and gas properties from 1983 to 1987. He received B.B.A., M.S. and J.D. degrees from Baylor University in 1978, 1980 and 1981, respectively.

**Roland O. Burns** has been Senior Vice President of the Company since 1994, Chief Financial Officer and Treasurer since 1990 and Secretary since 1991. From 1982 to 1990, Mr. Burns was employed by the public accounting firm, Arthur Andersen LLP. During his tenure with Arthur Andersen LLP, Mr. Burns worked primarily in the firm's oil and gas audit practice. Mr. Burns received B.A. and M.A. degrees from the University of Mississippi in 1982 and is a Certified Public Accountant.

**Mack D. Good** was appointed Vice President of Operations of the Company in March 1999. From August 1997 until his promotion, Mr. Good served as the Company's District Engineer for the East Texas/North Louisiana region. From 1983 until 1997, Mr. Good was with Enserch Exploration, Inc. serving in various operations management and engineering positions. Mr. Good received a B.S. of Biology/Chemistry from Oklahoma State University in 1975 and a B.S. of Petroleum Engineering from the University of Tulsa in 1983. He is a Registered Professional Engineer in the State of Texas.

**Stephen E. Neukom** has been Vice President of Marketing of the Company since December 1997 and has served as Manager of Crude Oil and Natural Gas Marketing since December 1996. From October 1994 to 1996, Mr. Neukom served as Vice President of Comstock Natural Gas, Inc., the Company's wholly



owned gas marketing subsidiary. Prior to joining the Company, Mr. Neukom was Senior Vice President of Victoria Gas Corporation from 1987 to 1994. Mr. Neukom received a B.B.A. degree from the University of Texas in 1972.

**Richard G. Powers** joined the Company as Land Manager in October 1994 and has been Vice President of Land since December 1997. Mr. Powers has over 20 years experience as a petroleum landman. Prior to joining the Company, Mr. Powers was employed for 10 years as Land Manager for Bridge Oil (U.S.A.), Inc. and its predecessor Pinoak Petroleum, Inc. Mr. Powers received a B.B.A. degree in 1976 from Texas Christian University.

**Daniel K. Presley** has been Vice President of Accounting since December 1997 and has been with the Company since December 1989 serving as Controller since 1991. Prior to joining the Company, Mr. Presley had six years of experience with several independent oil and gas companies including AmBrit Energy, Inc. Prior thereto, Mr. Presley spent two and one-half years with B.D.O. Seidman, a public accounting firm. Mr. Presley has a B.B.A. from Texas A & M University.

**Michael W. Taylor** has been Vice President of Corporate Development since December 1997 and has served the Company in various capacities since September 1994. Prior to joining the Company, Mr. Taylor had been an independent oil and gas producer and petroleum consultant for the previous 15 years. Mr. Taylor is a registered professional engineer in the state of Texas and he received a B.S. degree in Petroleum Engineering from Texas A & M University in 1974.

#### ***Outside Directors***

**Richard S. Hickok** has been a director of the Company since 1987. From 1948 to 1983, he was employed by the international accounting firm of Main Hurdman where he retired as Chairman. From 1978 to 1980, Mr. Hickok served as a Trustee of the Financial Accounting Foundation and has extensive involvement serving on various committees of the American Institute of Certified Public Accountants. Mr. Hickok holds a B.S. degree from the Wharton School of the University of Pennsylvania.

**Franklin B. Leonard** has been a director of the Company since 1960. From 1961 to 1994, Mr. Leonard served as President of Crossley Surveys, Inc., a New York based company which conducted statistical surveys. Mr. Leonard's family's involvement in the Company spans four generations dating back to the 1880's when Mr. Leonard's great grandfather was a significant shareholder of the Company. Mr. Leonard holds a B.S. degree from Yale University.

**Cecil E. Martin, Jr.** has been a director of the Company since 1988. From 1973 to 1991 he served as Chairman of a public accounting firm in Richmond, Virginia. Mr. Martin also serves as a director for CareerShop.com. Mr. Martin holds a B.B.A. degree from Old Dominion University and is a Certified Public Accountant.

**David W. Sledge** was elected to the Board of Directors of the Company in 1996. Mr. Sledge served as President of Gene Sledge Drilling Corporation, a privately held contract drilling company based in Midland, Texas until its sale in October 1996. Mr. Sledge served Gene Sledge Drilling Corporation in various capacities from 1979 to 1996. Mr. Sledge is a past director of the International Association of Drilling Contractors and is a past chairman of the Permian Basin chapter of this association. He received a B.B.A. degree from Baylor University in 1979.

### **ITEM 3. LEGAL PROCEEDINGS**

The Company is not a party to any legal proceedings which management believes will have a material adverse effect on the Company's consolidated results of operations or financial condition.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of the Company's security holders during the fourth quarter of 1998.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock is listed for trading on the New York Stock Exchange under the symbol "CRK". The following table sets forth, on a per share basis for the periods indicated, the high and low sales prices by calendar quarter for the periods indicated as reported by the New York Stock Exchange.

		<u>High</u>	<u>Low</u>
1997 -	First Quarter	\$ 14.38	\$ 8.13
	Second Quarter	10.88	6.63
	Third Quarter	12.94	9.88
	Fourth Quarter	17.50	10.63
1998 -	First Quarter	\$12.00	\$ 8.75
	Second Quarter	13.50	7.31
	Third Quarter	8.13	5.25
	Fourth Quarter	6.13	2.81

As of March 12, 1999, the Company had 24,350,452 shares of common stock outstanding, which were held by 734 holders of record and approximately 8,500 beneficial owners who maintain their shares in "street name" accounts.

The Company has never paid cash dividends on its common stock. The Company presently intends to retain any earnings for the operation and expansion of its business and does not anticipate paying cash dividends in the foreseeable future. Any future determination as to the payment of dividends will depend upon results of operations, capital requirements, the financial condition of the Company and such other factors as the Board of Directors of the Company may deem relevant. In addition, the Company is prohibited under the Company's bank credit facility from paying or declaring cash dividends.

## ITEM 6. SELECTED FINANCIAL DATA

The historical financial data presented in the table below as of and for each of the years in the five-year period ended December 31, 1998 are derived from the Consolidated Financial Statements of the Company. Significant acquisitions of producing oil and gas properties affect the comparability of the financial and operating data for the periods presented. The financial results are not necessarily indicative of the Company's future operations or financial results. The data presented below should be read in conjunction with the Company's Consolidated Financial Statements and the notes thereto included elsewhere herein and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	<b>Year Ended December 31,</b>				
	<b><u>1994</u></b>	<b><u>1995</u></b>	<b><u>1996</u></b>	<b><u>1997</u></b>	<b><u>1998</u></b>
<b>Statement of Operations Data:</b>					
(\$ in thousands, except per share data)					
Revenues:					
Oil and gas sales .....	\$ 16,855	\$ 22,091	\$ 68,915	\$ 88,555	\$ 92,961
Gain on sales of property .....	328	19	1,447	85	-
Other income .....	416	264	593	704	274
Total revenues .....	<u>17,599</u>	<u>22,374</u>	<u>70,955</u>	<u>89,344</u>	<u>93,235</u>
Expenses:					
Oil and gas operating(1) .....	6,099	7,427	13,838	17,919	24,747
Exploration .....	-	-	436	2,810	8,301
Depreciation, depletion and amortization ..	7,350	8,379	18,269	26,235	51,005
General and administrative, net .....	1,569	1,301	2,239	2,668	1,617
Interest .....	2,869	5,542	10,086	5,934	16,977
Impairment of oil and gas properties .....	-	29,150	-	-	17,000
Total expenses .....	<u>17,887</u>	<u>51,799</u>	<u>44,868</u>	<u>55,566</u>	<u>119,647</u>
Income (loss) from continuing operations before income taxes and extraordinary item ..	(288)	(29,425)	26,087	33,778	(26,412)
Income tax benefit (expense) .....	-	-	-	(11,622)	9,244
Net income (loss) from continuing operations before extraordinary item .....	(288)	(29,425)	26,087	22,156	(17,168)
Preferred stock dividends .....	(818)	(1,908)	(2,021)	(410)	-
Net income (loss) from continuing operations attributable to common stock before extraordinary item .....	(1,106)	(31,333)	24,066	21,746	(17,168)
Income from discontinued operations ....	229	3,264	1,866	-	-
Extraordinary loss .....	(615)	-	-	-	-
Net income (loss) attributable to common stock	<u>\$ (1,492)</u>	<u>\$ (28,069)</u>	<u>\$ 25,932</u>	<u>\$ 21,746</u>	<u>\$ (17,168)</u>
Weighted average shares outstanding:					
Basic .....	<u>12,065</u>	<u>12,546</u>	<u>15,449</u>	<u>24,186</u>	<u>24,275</u>
Diluted .....			<u>21,199</u>	<u>26,008</u>	
Basic earnings per share:					
Net income (loss) from continuing operations before extraordinary item .....	\$ (0.09)	\$ (2.50)	\$ 1.56	\$ 0.90	\$ (0.71)
Net income (loss) after extraordinary item ...	(0.12)	(2.24)	1.68	0.90	(0.71)
Diluted earnings per share:					
Net income (loss) from continuing operations before extraordinary item .....			\$ 1.23	\$ 0.85	
Net income (loss) after extraordinary item ....			1.32	0.85	
<b>Other Financial Data:</b>					
EBITDA(2) .....	\$ 9,931	\$ 13,646	\$ 54,878	\$ 68,757	\$ 66,871
Ratio of EBITDA to interest expense .....	3.5	2.5	5.4	11.3	3.5

	<b>As of December 31,</b>				
	<b><u>1994</u></b>	<b><u>1995</u></b>	<b><u>1996</u></b>	<b><u>1997</u></b> <b><u>1998</u></b>	
<b>Balance Sheet Data:</b>					
Cash and cash equivalents .....	\$ 3,425	\$ 1,917	\$ 16,162	\$ 14,504	\$ 5,176
Property and equipment, net .....	77,989	102,116	185,928	410,781	404,017
Total assets .....	91,571	120,099	222,002	456,800	429,672
Total debt .....	37,932	71,811	80,108	260,000	278,104
Stockholders' equity .....	41,205	30,128	118,216	124,594	109,663

(1) Includes lease operating costs and production and ad valorem taxes.

(2) EBITDA means income (loss) from continuing operations before income taxes, plus interest, depreciation, depletion and amortization, exploration expense and impairment of oil and gas properties. EBITDA is a financial measure commonly used in the Company's industry and should not be considered in isolation or as a substitute for net income, cash flow provided by operating activities or other income or cash flow data prepared in accordance with generally accepted accounting principles or as a measure of a company's profitability or liquidity.



## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Results of Operations

#### *General*

The Company's results of operations have been significantly affected by its success in acquiring producing oil and natural gas properties. Fluctuations in oil and natural gas prices have also influenced the Company's financial results. Relatively minor movements in oil and natural gas prices can lead to a change in the Company's results of operations and cash flow and could have an impact on the Company's borrowing base under its bank credit facility. Based on the 1998 operating results, a change in the average natural gas price realized by the Company of \$0.10 per Mcf would result in a change in net income attributable to common stock of approximately \$1.6 million, or \$0.07 per share. A change in the average oil price realized by the Company of \$1.00 per barrel would result in a change in net income attributable to common stock of approximately \$1.5 million or \$0.06 per share.

The following table reflects certain summary operating data for the periods presented:

	<u>Year Ended December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
<b>Net Production Data:</b>			
Oil (MBbls)	952	1,343	2,571
Natural gas (MMcf)	19,427	22,860	26,713
<b>Average Sales Price:</b>			
Oil (per Bbl)	\$ 21.96	\$ 19.47	\$ 12.73
Natural gas (per Mcf)	2.47	2.73	2.25
Average equivalent price (per Mcfe)	2.74	2.87	2.21
<b>Expenses (\$ per Mcfe):</b>			
Oil and gas operating(1)	\$ 0.55	\$ 0.58	\$ 0.59
General and administrative	0.09	0.09	0.04
Depreciation, depletion and amortization(2)	0.72	0.84	1.20
<b>Cash Margin (\$ per Mcfe)(3)</b>	<b>\$ 2.10</b>	<b>\$ 2.20</b>	<b>\$ 1.58</b>

(1) Includes lease operating costs and production and ad valorem taxes.

(2) Represents depreciation, depletion and amortization of oil and gas properties only.

(3) Represents average equivalent price per Mcfe less oil and gas operating expenses per Mcfe and general and administrative expenses per Mcfe.

#### *Year Ended December 31, 1998 Compared to Year Ended December 31, 1997*

Oil and gas sales increased \$4.4 million (5%) to \$93.0 million in 1998 from \$88.6 million in 1997. The increase is attributable to a 17% increase in natural gas production and a 92% increase in oil production, offset by 18% lower realized natural gas prices and 35% lower realized oil prices. The increase in production is attributable to the Bois d' Arc Acquisition completed in December 1997.

Other income in 1998 decreased \$430,000 (61%) to \$274,000 from \$704,000 for 1997. This decrease is attributable to a lower level of short-term cash deposits outstanding as well as the termination of management fee income previously received by the Company.

Oil and gas operating costs in 1998 increased \$6.8 million (38%) to \$24.7 million from \$17.9 million in 1997 due to the 36% increase in oil and gas production (on an equivalent Mcf basis). Oil and gas operating expenses per equivalent Mcf produced increased \$0.01 to \$0.59 in 1998 from \$0.58 in 1997.

Exploration expense for 1998 was \$8.3 million which relates to the write-off of the six unsuccessful exploratory wells, as compared to \$2.8 million in 1997.

Depreciation, depletion and amortization ("DD&A") increased \$24.8 million (94%) to \$51.0 million from \$26.2 million in 1997. The increase is due to a 36% increase in oil and natural gas production and to higher costs per unit of amortization. DD&A per equivalent Mcf increased by \$0.36 to \$1.20 in 1998 from \$0.84 in 1997. The increases in the DD&A rate relate to the higher costs of the offshore properties acquired in the Bois d' Arc Acquisition.

General and administrative expenses, which are reported net of overhead reimbursements, decreased \$1.1 million (39%) to \$1.6 million in 1997. The decrease is attributable to an increase in overhead reimbursements received by the Company in 1998 which was greater than the increase in the Company's overhead costs before reimbursements.

Interest expense in 1998 increased \$11.0 million (186%) to \$17.0 million in 1998 from \$5.9 million in 1997. The increase is related to a higher level of outstanding advances under the Company's bank credit facility due to the Bois d' Arc Acquisition completed in December 1997 as well as a higher average interest rate on the Company's bank credit facility. The weighted average annual interest rate under the Company's bank credit facility increased to 7.2% in 1998 as compared to 6.6% in 1997. The increase in the rate was attributable to a higher utilization of the borrowing base under the bank credit facility after the December 1997 acquisition.

Due to the substantial drop in oil and gas prices during 1998, the Company provided an impairment of \$17.0 million in 1998 of its oil and gas properties.

The Company had a deferred tax benefit of \$9.2 million for 1998, using an estimated tax rate of 35%.

The net loss for the year ended December 31, 1998 was \$17.2 million, as compared to net income of \$21.7 million, in 1997. Net loss per share for 1998 was \$0.71 on weighted average shares outstanding of 24.3 million as compared to net income per share of \$0.85 for 1997 on diluted weighted average shares outstanding of 26.0 million.

#### ***Year Ended December 31, 1997 Compared to Year Ended December 31, 1996***

Oil and gas sales increased \$19.6 million (28%) to \$88.6 million in 1997 from \$68.9 million in 1996 due primarily to a 18% increase in natural gas production and a 41% increase in oil production as well as higher natural gas prices. The production increases related primarily to production from the Black Stone Acquisition, which closed in May 1996 and the Bois d' Arc Acquisition which closed in December 1997. The Company's average gas price increased 11% and its average oil price decreased 11% during 1997 as compared to 1996.

Other income increased \$111,000 (19%) to \$704,000 in 1997 from \$593,000 in 1996 due primarily to additional interest income earned on an increased level of short-term cash deposits in 1997.

Oil and gas operating expenses, including production taxes, increased \$4.1 million (29%) to \$17.9 million in 1997 from \$13.8 million in 1996 due primarily to the 23% increase in oil and natural gas production (on an equivalent Mcf basis) resulting primarily from the acquisitions in 1996 and 1997. Oil and gas operating expenses per Mcfe produced increased 5% to \$0.58 in 1997 from \$0.55 in 1996 due primarily to increases in production taxes and ad valorem taxes which were related to the higher gas prices received in 1997.

General and administrative expenses increased \$429,000 (19%) to \$2.7 million in 1997 from \$2.2 million in 1996. This increase related to increased general corporate expenses associated with the increased size of the Company's operations.

DD&A increased \$8.0 million (44%) to \$26.2 million in 1997 from \$18.3 million in 1996 due to the 23% increase in oil and natural gas production (on an Mcfe basis). Oil and gas property DD&A per Mcfe produced of \$0.84 in 1997 increased from \$0.72 in 1996 due to the higher costs of the acquisitions closed in 1996 and 1997.

Interest expense decreased \$4.2 million (41%) to \$5.9 million in 1997 from \$10.1 million in 1996 due primarily to a decrease in the average outstanding advances under the Company's bank credit facility. The average annual interest rate paid under the Company's bank credit facility also decreased to 6.6% in 1997 as compared to 8.1% in 1996.

The Company provided for income taxes of \$11.6 million for 1997 using an estimated effective tax rate of 34%. No provision for income taxes was made in 1996 due to the availability of previously unrecognized tax assets relating to net operating loss carryforwards.

The Company reported net income of \$21.7 million, after preferred stock dividends of \$410,000, for the year ended December 31, 1997, as compared to a net income of \$24.1 million from continuing operations, after preferred stock dividends of \$2.0 million, for the year ended December 31, 1996. Net income per share for 1997 was \$0.85 on diluted average shares outstanding of 26.0 million as compared to \$1.23 for 1996 on diluted average shares outstanding of 21.2 million.

## Liquidity and Capital Resources

Funding for the Company's activities has historically been provided by operating cash flow, debt and equity financings and asset dispositions. In 1998 the Company's net cash flow provided by operating activities totaled \$40.7 million (\$50.2 million before changes to other working capital accounts). In addition to operating cash flow, the primary source of funds for the Company in 1998 was aggregate borrowings of \$23.2 million.

The Company's primary needs for capital, in addition to funding of ongoing operations, relate to the acquisition, development and exploration of oil and gas properties and the repayment of principal and interest on debt. In 1998, the Company repaid \$5.1 million of indebtedness and incurred capital expenditures of \$67.4 million primarily for development and exploration activities.

The Company's annual capital expenditure activity is summarized as follows:

	<u>Year Ended December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(In thousands)		
Acquisition of oil and gas properties	\$ 100,446	\$ 220,054	\$ 2,453
Other leasehold costs	93	2,304	3,622
Workovers and recompletions	2,972	2,517	10,198
Development drilling	7,964	22,765	20,361
Exploratory drilling	436	6,043	30,423
Other	<u>51</u>	<u>1,160</u>	<u>330</u>
Total	<u>\$ 111,962</u>	<u>\$ 254,843</u>	<u>\$ 67,387</u>

The timing of most of the Company's capital expenditures is discretionary with no material long-term capital expenditure commitments. Consequently, the Company has a significant degree of flexibility to adjust the level of such expenditures as circumstances warrant. The Company spent \$11.5 million, \$33.6 million and \$64.6 million on development and exploration activities in 1996, 1997 and 1998, respectively. The Company currently anticipates spending approximately \$10.0 to \$36.0 million on development and exploration projects in 1999. The Company intends to primarily use internally generated cash flow to fund capital expenditures other than significant acquisitions and plans to limit drilling expenditures in 1999 to available cash flow after debt service payments. Such debt service payments are expected to require a substantial amount of the Company's available cash flow unless oil and gas prices improve from current levels. Without an improvement in oil and gas prices or the completion of a debt or equity financing, the Company's 1999 total capital expenditures will probably be limited to \$10.0 million to \$15.0 million.

The Company does not have a specific acquisition budget as a result of the unpredictability of the timing and size of forthcoming acquisition activities. The Company intends to use borrowings under its bank credit facility or other debt or equity financings to the extent available to finance significant acquisitions. The availability and attractiveness of these sources of financing will depend upon a number of factors, some of which will relate to the financial condition and performance of the Company, and some of which will be beyond the Company's control, such as prevailing interest rates, oil and gas prices and other market conditions.

The Company's bank credit facility consists of a \$280.0 million revolving credit commitment provided by a syndicate of ten banks for which The First National Bank of Chicago serves as administrative agent. Indebtedness under the bank credit facility is secured by substantially all of the Company's assets. The Company's bank credit facility is subject to borrowing base availability which is generally redetermined semiannually based on the banks' estimates of the future net cash flows of the Company's oil and gas properties. As of December 31, 1998, the borrowing base was \$280.0 million and is scheduled to reduce to \$240.0 million by December 31, 1999 and by an additional \$20.0 million by January 1, 2000. Such borrowing base may be affected from time to time by the performance of the Company's oil and gas properties and changes in oil and gas prices. The determination of the Company's borrowing base is at the sole discretion of the administrative agent and the bank group. The next scheduled borrowing base redetermination will occur in April 1999; however, the bank group can request a redetermination at any time. The revolving credit line bears interest at the option of the Company at either (i) LIBOR plus 2.25% or (ii) the "corporate base rate" plus 1.25%. The Company incurs a commitment fee of up to 0.5% per annum on the unused portion of the borrowing base. The average annual interest rate as of December 31, 1998 of all outstanding indebtedness under the Company's bank credit facility was approximately 7.6%. The revolving credit line matures on December 9, 2002 or such earlier date as the Company may elect. The credit facility contains covenants which, among other things, restrict the payment of cash dividends, limit the amount of consolidated debt, and limit the Company's ability to make certain loans, capital expenditures and investments. Significant financial covenants include the maintenance of a current ratio, as defined, (0.75 to 1.0), maintenance of tangible net worth (\$98.0 million), maintenance of an interest coverage ratio (2.5 to 1), and a limitation on capital expenditures (\$30.0 million).

Based on the scheduled borrowing base reductions in 1999, the Company has classified \$38.0 million of the amount outstanding under its bank credit facility as a current liability at December 31, 1998. The Company plans to reduce its drilling expenditures in 1999 as compared to 1998 and utilize cash flow generated from operations to reduce outstanding borrowings under the bank credit facility. The Company believes that it will generate sufficient operating cash flow during 1999 to reduce the amounts outstanding under the bank credit facility in accordance with the scheduled reductions to the borrowing base. The Company intends to refinance the additional \$20.0 million reduction to the borrowing base scheduled to occur in January 2000 with a future debt or equity financing or to pay down such debt from proceeds from sale of existing properties.

Management cannot be assured that such debt or equity financing will be available for the Company on the terms acceptable to its existing shareholders or that the banks will not require additional reductions to the borrowing base in the future.

Based on estimated 1999 oil and natural gas production, the Company estimates a change in the average natural gas price realized by the Company of \$0.10 per Mcf on unhedged production would result in a change in cash flow of approximately \$1.5 million. Also, the Company estimates a change in the average oil price realized by the Company of \$1.00 per barrel on unhedged production would result in a change in cash flow of approximately \$2.9 million. If oil and gas prices were to fall significantly below current levels for the remainder of 1999 or if the banks were to further reduce the Company's borrowing base, the Company would likely have to complete a debt or equity financing or sell selected properties in order to meet the required 1999 scheduled reductions to its borrowing base.

The Company may consider additional debt or equity financings in order to provide liquidity and working capital for attractive acquisition opportunities during the current depressed price environment of the industry. Based on the current low oil and gas price environment, there can be no assurance that such capital would be available with terms and conditions acceptable to the Company or its existing stockholders.

### **Federal Taxation**

At December 31, 1998, the Company had federal income tax net operating loss ("NOL") carryforwards of approximately \$57.4 million. The NOL carryforwards expire from 2005 through 2018. The value of these carryforwards depends on the ability of the Company to generate federal taxable income and to utilize the carryforwards to reduce such income.

### **Inflation**

In recent years inflation has not had a significant impact on the Company's operations or financial condition.

### **Risk Management**

The Company's market risk exposures relate primarily to commodity prices and interest rates. Therefore, the Company periodically uses commodity price swaps to hedge the impact of natural gas price fluctuations and uses interest rate swaps to hedge interest rates on floating rate debt. The Company does not engage in activities using complex or highly leveraged instruments. These instruments are generally put in place to limit risk of adverse natural gas price or interest rate movements, however, these instruments usually limit future gains from favorable natural gas price or lower interest rates. Recognition of realized gains or losses are deferred until the underlying physical product is purchased or sold. Unrealized gains or losses on derivative financial instruments are not recorded. The cash flow impact of derivative and other financial instruments is reflected as cash flows from operating activities.

As a result of certain hedging transactions for natural gas the Company's average realized natural gas price has been impacted as follows:

	<u>Year Ended December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
Percent of natural gas production hedged	15%	-	7%
Price realized without hedging (per Mcf)	\$ 2.53	\$ 2.73	\$ 2.24
Increase (decrease) in price realized (per Mcf)	\$ (0.06)	-	\$ 0.01



As of December 31, 1998, the Company had no open derivative financial instruments held for price risk management. Subsequent to December 31, 1998, the Company entered into natural gas price swaps covering 10,480,000 MMBtus of its natural gas production for March 1999 to October 1999 at 1,310,000 MMBtus per month at a fixed index price of \$1.81 (after basis adjustment), which represents approximately 60% of the Company's estimated gas production for that period.

The table below provides information about the Company's derivative financial instruments that are sensitive to changes in interest rates, including interest rate swaps and debt obligations. For interest rate swaps, the table presents notional amounts and weighted average interest rates by contractual maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged under the contract. Weighted average variable rates are based on implied forward rates in the yield curve as of December 31, 1998.

	<u>Expected Maturity Date</u>					<u>Fair Value as of December 31, 1998</u>
	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>Total</u>	
	(\$ in thousands)					
Liabilities:						
Bank credit facility	\$ 38,000	\$ 20,000	\$ -	\$ 220,000	\$ 278,000	\$ 278,000
Variable rate	7.2%	7.2%	-	7.4%	7.4%	
Interest Rate Swaps:						
Variable to fixed	\$ -	\$ -	\$ -	\$ 125,000	\$ 125,000	(95)
Average pay rate				5.0%	5.0%	
Average receive rate				5.1%	5.1%	

## Year 2000

"Year 2000," or the ability of computer systems to process dates with years beyond 1999, affects almost all companies and organizations. Computer systems that are not Year 2000 compliant by January 1, 2000 may cause an adverse effect to companies and organizations that rely upon those systems. The Company is assessing and correcting the potential impact of problems with computer software, operating systems, and equipment containing computer processing chips that are unable to properly process dates beyond 1999. The Company has outsourced its significant financial information systems. Based on information received from the Company's providers, the Company is relying on assurances from the providers that they are Year 2000 compliant. The Company's costs related to Year 2000 have not been significant and it expects future costs will not be material.

Because the Company outsources its information technology systems and software, it believes that there is little risk associated with Year 2000 for its information systems. The Company believes that there is minimal risk with embedded technology associated with its operations because it does not own any significant gas processing plants or pipelines, nor does it have any significant electronic field data capture systems on its wells. However, the Company cannot provide assurance that all significant third parties will achieve compliance in a timely manner. Such failure to achieve Year 2000 compliance could have an adverse effect on the Company's operations and cash flow due to potential shut-in production or delay in drilling schedules. Although the Company does not have a formal contingency plan, it stands ready to switch from vendors that are not Year 2000 compliant.

## **ITEM 8. FINANCIAL STATEMENTS**

The Consolidated Financial Statements for Comstock Resources, Inc. and Subsidiaries are included on pages F-1 to F-19 of this report.

The financial statements have been prepared by the management of the Company in conformity with generally accepted accounting principles. Management is responsible for the fairness and reliability of the financial statements and other financial data included in this report. In the preparation of the financial statements, it is necessary to make informed estimates and judgments based on currently available information on the effects of certain events and transactions.

The Company maintains accounting and other controls which management believes provide reasonable assurance that financial records are reliable, assets are safeguarded, and that transactions are properly recorded in accordance with management's authorizations. However, limitations exist in any system of internal control based upon the recognition that the cost of the system should not exceed benefits derived.

The Company's independent public accountants, Arthur Andersen LLP, are engaged to audit the financial statements of the Company and to express an opinion thereon. Their audit is conducted in accordance with generally accepted auditing standards to enable them to report whether the financial statements present fairly, in all material respects, the financial position and results of operations of the Company in accordance with generally accepted accounting principles.

The Audit Committee of the Board of Directors of the Company, composed of three directors who are not employees, meets periodically with the independent public accountants and management. The independent public accountants have full and free access to the Audit Committee to meet, with and without management being present, to discuss the results of their audits and the quality of financial reporting.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not applicable.

### **PART III**

#### **ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

The information required by this item is incorporated herein by reference to the Company's definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 1998.

#### **ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item is incorporated herein by reference to the Company's definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 1998.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The information required by this item is incorporated herein by reference to the Company's definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 1998.

#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information required by this item is incorporated herein by reference to the Company's definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 1998.

## PART IV

### ITEM 14. EXHIBITS AND REPORTS ON FORM 8-K

#### Exhibits:

The following exhibits are included on pages E-1 to E-61 of this report.

<b>Exhibit No.</b>	<b>Description</b>
3.1(a)	Restated Articles of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1995).
3.1(b)	Certificate of Amendment to the Restated Articles of Incorporation dated July 1, 1997 (incorporated herein by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997).
3.2	Bylaws of the Company (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-3, dated October 25, 1996).
4.2(a)	Rights Agreement dated as of December 10, 1990, by and between the Company and Society National Bank, as Rights Agent (incorporated herein by reference to Exhibit 1 to the Company's Registration Statement on Form 8-A, dated December 14, 1990).
4.2(b)	First Amendment to the Rights Agreement, by and between the Company and Society National Bank (successor to Ameritrust Texas, N.A.), as Rights Agent, dated January 7, 1994 (incorporated herein by reference to Exhibit 3.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 1993).
4.2(c)	Second Amendment to the Rights Agreement, by and between the Company and Bank One, Texas N.A. (successor to Society National Bank), as Rights Agent, dated April 1, 1995 (incorporated by reference to Exhibit 4.7 to the Company's Annual Report on Form 10-K for the ended December 31, 1995).
4.2(d)	Third Amendment to the Rights Agreement, by and between the Company and Bank One, Texas N.A. (successor to Society National Bank), as Rights Agent, dated April 1, 1995 (incorporated by reference to Exhibit 4.8 to the Company's Annual Report on Form 10-K for the ended December 31, 1995).
4.2(e)	Fourth Amendment to the Rights Agreement, by and between the Company and Bank One, Texas N.A. (successor to Society National Bank), as Rights Agent, dated April 1, 1995 (incorporated by reference to Exhibit 4.9 to the Company's Annual Report on Form 10-K for the ended December 31, 1995).
4.3	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock dated December 6, 1990 (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-3, dated October 25, 1996).
10.1(a)*	Credit Agreement dated as of December 23, 1998, between the Company, the Banks Party thereto and The First National Bank of Chicago, as Administrative Agent and Toronto Dominion (Texas), Inc., as Syndication Agent.
10.2#	Employment Agreement dated May 11, 1998, by and between the Company and M. Jay Allison (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998).
10.3#	Employment Agreement dated May 11, 1998, by and between the Company and Roland O. Burns (incorporated herein by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998).

Exhibit No.	Description
10.4#	Change in Control Employment Agreement dated May 15, 1997, by and between the Company and M. Jay Allison (incorporated herein by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997).
10.5#	Change in Control Employment Agreement dated May 15, 1997, by and between the Company and Roland O. Burns (incorporated herein by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997).
10.6(a)#	Comstock Resources, Inc. 1991 Long-term Incentive Plan, dated as of April 1, 1991 (incorporated herein by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991).
10.6(b)#	Amendment No. 1 to the Comstock Resources, Inc. 1991 Long-term Incentive Plan (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1996).
10.7#	Form of Nonqualified Stock Option Agreement, dated April 2, 1991, between the Company and certain officers and directors of the Company (incorporated herein by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991).
10.8#	Form of Restricted Stock Agreement, dated April 2, 1991, between the Company and certain officers of the Company (incorporated herein by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991).
10.9	Form of Stock Option Agreement, dated October 12, 1994 by and between the Company and Christopher T. H. Pell, et al. (incorporated herein by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 1994).
10.10	Warrant Agreement dated December 9, 1997 by and between the Company and Bois d' Arc Resources (incorporated herein by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.11	Joint Exploration Agreement dated December 8, 1997 by and between the Company and Bois d' Arc Resources (incorporated herein by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.12	Office Lease Agreement dated August 12, 1997 between the Company and Briar Center LLC (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1997).
21*	Subsidiaries of the Company.
23*	Consent of Arthur Andersen LLP.
27*	Financial Data Schedule for the twelve months ended December 31, 1998.

\*Filed herewith.

# Management contract or compensatory plan document.

### Reports on Form 8-K:

There were no reports filed on Form 8-K filed subsequent to September 30, 1998 to the date of this report.



## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### COMSTOCK RESOURCES, INC.

By: /s/M. JAY ALLISON

M. Jay Allison

President and Chief Executive Officer

(Principal Executive Officer)

Date: March 12, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>/s/M. JAY ALLISON</u> M. Jay Allison	President, Chief Executive Officer and Chairman of the Board of Directors (Principal Executive Officer)	March 12, 1999
<u>/s/ROLAND O. BURNS</u> Roland O. Burns	Senior Vice President, Chief Financial Officer, Secretary and Treasurer (Principal Financial and Accounting Officer)	March 12, 1999
<u>/s/RICHARD S. HICKOK</u> Richard S. Hickok	Director	March 12, 1999
<u>/s/FRANKLIN B. LEONARD</u> Franklin B. Leonard	Director	March 12, 1999
<u>/s/CECIL E. MARTIN, JR.</u> Cecil E. Martin, Jr.	Director	March 12, 1999
<u>/s/DAVID W. SLEDGE</u> David W. Sledge	Director	March 12, 1999

**CONSOLIDATED FINANCIAL STATEMENTS OF  
COMSTOCK RESOURCES, INC. AND SUBSIDIARIES**

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## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders  
of Comstock Resources, Inc.:

We have audited the accompanying consolidated balance sheets of Comstock Resources, Inc. (a Nevada corporation) and subsidiaries as of December 31, 1997 and 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Comstock Resources, Inc. and subsidiaries as of December 31, 1997 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Dallas, Texas,  
February 15, 1999

## COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEETS

As of December 31, 1997 and 1998

#### ASSETS

	December 31,	
	1997	1998
	(In thousands)	
Cash and Cash Equivalents .....	\$ 14,504	\$ 5,176
Accounts Receivable:		
Oil and gas sales .....	24,509	13,355
Joint interest operations .....	6,732	4,506
Other Current Assets .....	172	1,457
Total current assets .....	45,917	24,494
Property and Equipment:		
Unevaluated oil and gas properties .....	30,291	436
Oil and gas properties, successful efforts method .....	456,606	547,372
Other .....	1,561	1,648
Accumulated depreciation, depletion and amortization .....	(77,677)	(145,439)
Net property and equipment .....	410,781	404,017
Other Assets .....	102	1,161
	\$ 456,800	\$ 429,672

#### LIABILITIES AND STOCKHOLDERS' EQUITY

Current Portion of Long-Term Debt .....	\$ -	\$ 38,104
Accounts Payable and Accrued Expenses .....	56,184	34,652
Total current liabilities .....	56,184	72,756
Long-Term Debt, less current portion .....	260,000	240,000
Deferred Taxes Payable .....	11,207	1,778
Reserve for Future Abandonment Costs .....	4,815	5,475
Stockholders' Equity:		
Preferred stock--\$10.00 par, 5,000,000 shares authorized, no shares outstanding .....	-	-
Common stock--\$0.50 par, 50,000,000 shares authorized, 24,208,785 and 24,350,452 shares outstanding at December 31, 1997 and 1998, respectively .....	12,104	12,175
Additional paid-in capital .....	110,273	112,432
Retained earnings (deficit) .....	2,234	(14,934)
Less: Deferred compensation-restricted stock grants .....	(17)	(10)
Total stockholders' equity .....	124,594	109,663
	\$ 456,800	\$ 429,672

The accompanying notes are an integral part of these statements.

## COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF OPERATIONS For the Years Ended December 31, 1996, 1997 and 1998

	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(In thousands, except per share amounts)		
Revenues:			
Oil and gas sales .....	\$ 68,915	\$ 88,555	\$ 92,961
Gain on sales of property .....	1,447	85	-
Other income .....	593	704	274
Total revenues .....	<u>70,955</u>	<u>89,344</u>	<u>93,235</u>
Expenses:			
Oil and gas operating .....	13,838	17,919	24,747
Exploration .....	436	2,810	8,301
Depreciation, depletion and amortization .....	18,269	26,235	51,005
General and administrative, net .....	2,239	2,668	1,617
Interest .....	10,086	5,934	16,977
Impairment of oil and gas properties .....	-	-	17,000
Total expenses .....	<u>44,868</u>	<u>55,566</u>	<u>119,647</u>
Income (loss) from continuing operations before income taxes .....	26,087	33,778	(26,412)
Income tax benefit (expense) .....	-	(11,622)	9,244
Net income (loss) from continuing operations .....	26,087	22,156	(17,168)
Preferred stock dividends .....	(2,021)	(410)	-
Net income (loss) from continuing operations attributable to common stock .....	24,066	21,746	(17,168)
Income from discontinued gas gathering, processing and marketing operations including gain on disposal .....	1,866	-	-
Net income (loss) attributable to common stock .....	<u>\$ 25,932</u>	<u>\$ 21,746</u>	<u>\$ (17,168)</u>
Net income (loss) per share:			
Basic -			
Net income (loss) per share from continuing operations .....	<u>\$ 1.56</u>	<u>\$ 0.90</u>	<u>\$ (0.71)</u>
Net income (loss) per share .....	<u>\$ 1.68</u>	<u>\$ 0.90</u>	<u>\$ (0.71)</u>
Diluted -			
Net income (loss) per share from continuing operations .....	<u>\$ 1.23</u>	<u>\$ 0.85</u>	
Net income (loss) per share .....	<u>\$ 1.32</u>	<u>\$ 0.85</u>	
Weighted average shares outstanding:			
Basic .....	<u>15,449</u>	<u>24,186</u>	<u>24,275</u>
Diluted .....	<u>21,199</u>	<u>26,008</u>	

The accompanying notes are an integral part of these statements.



**COMSTOCK RESOURCES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

**For the Years Ended December 31, 1996, 1997 and 1998**

	<u>Preferred Stock</u>	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings (Deficit)</u>	<u>Deferred Compensation- Restricted Stock Grants</u>	<u>Total</u>
	(In thousands)					
Balance at December 31, 1995 .....	\$ 31,000	\$ 6,463	\$ 38,183	\$ (45,444)	\$ (74)	\$ 30,128
Conversion of preferred stock .....	(23,937)	2,506	21,431	-	-	-
Issuance of common stock .....	-	3,082	59,033	-	-	62,115
Restricted stock grants .....	-	-	-	-	41	41
Net income attributable to common stock .....	-	-	-	25,932	-	25,932
Balance at December 31, 1996 .....	<u>7,063</u>	<u>12,051</u>	<u>118,647</u>	<u>(19,512)</u>	<u>(33)</u>	<u>118,216</u>
Conversion of preferred stock .....	(7,063)	673	6,390	-	-	-
Issuance of common stock .....	-	53	708	-	-	761
Repurchase of common stock .....	-	(673)	(15,472)	-	-	(16,145)
Restricted stock grants .....	-	-	-	-	16	16
Net income attributable to common stock .....	-	-	-	21,746	-	21,746
Balance at December 31, 1997 .....	<u>-</u>	<u>12,104</u>	<u>110,273</u>	<u>2,234</u>	<u>(17)</u>	<u>124,594</u>
Issuance of common stock .....	-	71	664	-	-	735
Value of stock options issued for exploration prospects .....	-	-	1,495	-	-	1,495
Restricted stock grants .....	-	-	-	-	7	7
Net loss attributable to common stock .....	-	-	-	(17,168)	-	(17,168)
Balance at December 31, 1998 .....	<u>\$ -</u>	<u>\$ 12,175</u>	<u>\$ 112,432</u>	<u>\$ (14,934)</u>	<u>\$ (10)</u>	<u>\$ 109,663</u>

The accompanying notes are an integral part of these statements.

## COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS For the Years Ended December 31, 1996, 1997 and 1998

	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(In thousands)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (loss) . . . . .	\$ 27,953	\$ 22,156	\$ (17,168)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Compensation paid in common stock . . . . .	196	129	269
Depreciation, depletion and amortization . . . . .	18,642	26,235	51,005
Impairment of oil and gas properties . . . . .	-	-	17,000
Deferred income taxes . . . . .	-	11,363	(9,244)
Deferred revenue . . . . .	(430)	-	-
Exploration . . . . .	436	2,810	8,301
Gain on sales of property . . . . .	<u>(2,265)</u>	<u>(85)</u>	<u>-</u>
Working capital provided by operations . . . . .	44,532	62,608	50,163
Decrease (increase) in accounts receivable . . . . .	(4,764)	(11,744)	13,380
Decrease (increase) in other current assets . . . . .	86	2	(1,285)
Increase (decrease) in accounts payable and accrued expenses . . . . .	<u>6,065</u>	<u>33,411</u>	<u>(21,532)</u>
Net cash provided by operating activities . . . . .	<u>45,919</u>	<u>84,277</u>	<u>40,726</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from sales of properties . . . . .	9,016	5,079	-
Proceeds from sale of discontinued operations . . . . .	3,036	-	-
Capital expenditures and acquisitions . . . . .	<u>(111,962)</u>	<u>(254,843)</u>	<u>(67,387)</u>
Net cash used for investing activities . . . . .	<u>(99,910)</u>	<u>(249,764)</u>	<u>(67,387)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Borrowings . . . . .	172,150	295,000	23,238
Debt issuance costs . . . . .	-	-	(1,059)
Principal payments on debt . . . . .	(163,853)	(115,108)	(5,134)
Proceeds from common stock issuances . . . . .	61,503	507	288
Repurchase of common stock . . . . .	-	(16,145)	-
Stock issuance costs . . . . .	(863)	(15)	-
Dividends paid on preferred stock . . . . .	<u>(701)</u>	<u>(410)</u>	<u>-</u>
Net cash provided by financing activities . . . . .	<u>68,236</u>	<u>163,829</u>	<u>17,333</u>
Net increase (decrease) in cash and cash equivalents . . . . .	14,245	(1,658)	(9,328)
Cash and cash equivalents, beginning of year . . . . .	<u>1,917</u>	<u>16,162</u>	<u>14,504</u>
Cash and cash equivalents, end of year . . . . .	<u>\$ 16,162</u>	<u>\$ 14,504</u>	<u>\$ 5,176</u>

The accompanying notes are an integral part of these statements.

## COMSTOCK RESOURCES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### (1) Business and Organization

Comstock Resources, Inc., a Nevada corporation (together with its subsidiaries, the "Company"), was formed in 1919 as Comstock Tunnel and Drainage Company. In 1987, the Company's name was changed to Comstock Resources, Inc. The Company is primarily engaged in the acquisition, development, production and exploration of oil and natural gas properties in the United States.

#### (2) Significant Accounting Policies

##### *Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

##### *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

##### *Concentrations of Credit Risk*

Although the Company's cash equivalents and accounts receivable are exposed to credit loss, the Company does not believe such risk to be significant. Cash equivalents are high-grade, short-term securities, placed with highly rated financial institutions. Most of the Company's accounts receivable are from a broad and diverse group of oil and gas companies and, accordingly, do not represent a significant credit risk.

##### *Oil and Gas Properties*

The Company follows the successful efforts method of accounting for its oil and gas operations. Under this method, costs of productive wells, development dry holes and productive leases are capitalized and amortized on a unit-of-production basis over the life of the remaining related oil and gas reserves. Cost centers for amortization purposes are determined on a field area basis. The estimated future costs of dismantlement, restoration and abandonment are accrued as part of depreciation, depletion and amortization expense and included in the accompanying Consolidated Balance Sheets as Reserve for Future Abandonment Costs.

Oil and gas leasehold costs are capitalized. Unproved oil and gas properties with significant acquisition costs are periodically assessed and any impairment in value is charged to expense. The costs of unproved properties which are determined to be productive are transferred to proved oil and gas properties. Exploratory expenses, including geological and geophysical expenses and delay rentals for unevaluated oil and gas properties, are charged to expense as incurred. Exploratory drilling costs are initially capitalized as unproved property but charged to expense if and when the well is determined not to have found proved oil and gas reserves.

In accordance with the Statement of Financial Accounting Standards No. 121 ("SFAS 121") "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of", the Company assesses the need for an impairment of capitalized costs of oil and gas properties on a property by property basis. If an impairment is indicated based on undiscounted expected future cash flows, then an impairment is recognized to the extent that net capitalized costs exceed discounted expected future cash flows. No impairment was required in 1996 or 1997. Due to the substantial drop in oil and gas prices during 1998, the Company provided an impairment of \$17.0 million in 1998.

### ***Other Property and Equipment***

Other property and equipment of the Company consists primarily of work boats, a gas gathering system, computer equipment, and furniture and fixtures which are depreciated over estimated useful lives on a straight-line basis.

### ***Income Taxes***

Deferred income taxes are provided to reflect the future tax consequences of differences between the tax basis of assets and liabilities and their reported amounts in the financial statements using enacted tax rates.

### ***Earnings Per Share***

Basic and diluted earnings per share for 1996, 1997 and 1998 were determined as follows:

	For the Year Ended December 31,								
	1996			1997			1998		
	<u>Income</u>	<u>Shares</u>	<u>Per Share</u>	<u>Income</u>	<u>Shares</u>	<u>Per Share</u>	<u>Income (Loss)</u>	<u>Shares</u>	<u>Per Share</u>
(In thousands, except per share amounts)									
<i>Basic Earnings Per Share:</i>									
Income (Loss) from									
Continuing Operations	\$ 26,087	15,449		\$ 22,156	24,186		\$ (17,168)	24,275	\$ (0.71)
Less Preferred Stock									
Dividends	(2,021)	-		(410)	-		-	-	-
Net Income (Loss) Available to Common Stockholders	\$ 24,066	15,449	<u>\$ 1.56</u>	21,746	24,186	<u>\$ 0.90</u>	<u>\$ (17,168)</u>	<u>24,275</u>	<u>\$ (0.71)</u>
<i>Diluted Earnings Per Share:</i>									
Effect of Dilutive Securities:									
Stock Options	-	922		-	967				
Convertible Preferred Stock	2,021	4,828		410	855				
Net Income Available to Common Stockholders and Assumed Conversions	<u>\$ 26,087</u>	<u>21,199</u>	<u>\$ 1.23</u>	<u>\$ 22,156</u>	<u>26,008</u>	<u>\$ 0.85</u>			

### ***Statements of Cash Flows***

For the purpose of the consolidated statements of cash flows, the Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

The following is a summary of all significant noncash investing and financing activities and cash payments made for interest and income taxes:

	<u>Year Ended December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(In thousands)		
Noncash activities -			
Common stock issued for compensation	\$ 154	\$ 113	\$ 269
Value of vested stock options under exploration venture	-	-	1,495
Common stock issued in payment of preferred stock dividends	1,320	-	-
Cash payments -			
Interest payments	9,934	5,112	19,898
Income tax payments	-	270	-

### ***New Accounting Standard***

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). The Statement establishes accounting and reporting standards that are effective for the fiscal years beginning after June 15, 1999 which require that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. The Statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met.

The Company uses derivatives to hedge floating interest rate and natural gas price risks. Such derivatives are reported at cost, if any, and gains and losses on such derivatives are reported when the hedged transaction occurs. Accordingly, the Company's adoption of SFAS No. 133 will have an impact on the reported financial position of the Company, and although such impact has not been determined, it is currently not believed to be material. Adoption of SFAS No. 133 should have no significant impact on reported earnings, but could materially affect comprehensive income.

### **(3) Acquisitions of Oil and Gas Properties**

On May 7, 1997, the Company purchased certain producing oil and gas properties located in the Lisbon field in Claiborne Parish, Louisiana for a net purchase price of \$20.1 million. The acquisition included interests in 13 wells (7.1 net wells).

On December 9, 1997, the Company acquired interests in certain offshore Louisiana oil and gas properties as well as interests in undeveloped oil and gas leases for \$200.9 million from Bois d' Arc Resources ("Bois d' Arc") and certain affiliates and working interest partners of Bois d' Arc. The Company acquired interests in 43 wells (29.6 net wells) and eight separate production complexes located in the Gulf of Mexico offshore of Plaquemines and Terrebonne Parishes, Louisiana. The acquisition included interests in the Louisiana state and federal offshore areas of Main Pass Blocks 21 and 25, Ship Shoal Blocks 66, 67, 68 and 69 and South Pelto Block 1. Approximately \$30.2 million of the purchase price was attributed to the undrilled prospects and \$1.0 million of the purchase price was attributed to other assets.



The acquisitions were accounted for utilizing the purchase method of accounting. The accompanying consolidated statements of operations include the results of operations from the acquired properties beginning on the dates that the acquisitions were closed. The following table summarizes the unaudited pro forma effect on the Company's consolidated statements of operations as if the acquisitions consummated in 1997 had been closed on January 1, 1997. Future results may differ substantially from pro forma results due to changes in prices received for oil and gas sold, production declines and other factors. Therefore, the pro forma amounts should not be considered indicative of future operations.

**Unaudited 1997 Pro Forma Results -**

Total Revenues (000s)	\$ 144,313
Net income from continuing operations attributable to common stock (000s)	27,327
Net income from continuing operations per share:	
Basic	1.13
Diluted	1.07

**(4) Sales of Oil and Gas Properties**

The Company sold certain oil and gas properties for approximately \$9.0 million and \$5.1 million in 1996 and 1997, respectively. The properties sold were non-strategic assets to the Company. Gains from the property sales of \$1.4 million and \$85,000 are included in the accompanying Consolidated Statements of Operations for 1996 and 1997, respectively.

**(5) Oil and Gas Producing Activities**

Set forth below is certain information regarding the aggregate capitalized costs of oil and gas properties and costs incurred in oil and gas property acquisition, development and exploration activities:

***Capitalized Costs***

	<b><u>As of December 31,</u></b>	
	<b><u>1997</u></b>	<b><u>1998</u></b>
	<b>(In thousands)</b>	
Proved properties	\$ 456,606	\$ 547,372
Unproved properties	30,291	436
Accumulated depreciation, depletion and amortization	<u>(77,414)</u>	<u>(145,152)</u>
	<b><u>\$ 409,483</u></b>	<b><u>\$ 402,656</u></b>

***Costs Incurred***

	<b><u>For the Year Ended December 31,</u></b>		
	<b><u>1996</u></b>	<b><u>1997</u></b>	<b><u>1998</u></b>
	<b>(In thousands)</b>		
Property acquisitions:			
Proved properties	\$ 100,539	\$ 190,708	\$ -
Unproved properties	-	31,650	6,075
Development costs	10,936	25,282	30,559
Exploration costs	<u>436</u>	<u>6,043</u>	<u>30,423</u>
	<b><u>\$ 111,911</u></b>	<b><u>\$ 253,683</u></b>	<b><u>\$ 67,057</u></b>

The following presents the results of operations of oil and gas producing activities for the three years in the period ended December 31, 1998:

	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(In thousands)		
Oil and gas sales	\$ 68,915	\$ 88,555	\$ 92,961
Production costs	(13,838)	(17,919)	(24,747)
Exploration	(436)	(2,810)	(8,301)
Depreciation, depletion and amortization	(18,162)	(26,111)	(50,738)
Impairment of oil and gas properties	-	-	(17,000)
Operating income (loss)	36,479	41,715	(7,825)
Income tax	-	(14,353)	2,739
Results of operations (excluding general and administrative and interest expenses)	<u>\$ 36,479</u>	<u>\$ 27,362</u>	<u>\$ (5,086)</u>

## (6) Long-Term Debt

Total debt at December 31, 1997 and 1998 consists of the following:

	<u>1997</u>	<u>1998</u>
	(In thousands)	
Bank Credit Facility	\$ 260,000	\$ 278,000
Other	-	104
	260,000	278,104
Less current portion	-	(38,104)
	<u>\$ 260,000</u>	<u>\$ 240,000</u>

The Company has a \$280.0 million revolving credit facility with a syndication of ten banks in which The First National Bank of Chicago serves as administrative agent, (the "Bank Credit Facility"). As of December 31, 1998, the Company had \$278.0 million outstanding under the Bank Credit Facility. Borrowings under the Bank Credit Facility cannot exceed a borrowing base determined semiannually by the banks. The borrowing base at December 31, 1998 was \$280.0 million. The borrowing base is scheduled to reduce to \$240.0 million by December 31, 1999 and will reduce by an additional \$20.0 million by January 1, 2000. The determination of the Company's borrowing base is at the sole discretion of the administrative agent and the bank group. The next scheduled borrowing base redetermination will occur in April 1999; however, the bank group can request a redetermination at any time. Amounts outstanding under the Bank Credit Facility bear interest at a floating rate based on The First National Bank of Chicago's base rate (as defined) plus 1.25% or, at the Company's option, at a fixed rate for up to six months based on the London Interbank Offered Rate ("LIBOR") plus 2.25%. As of December 31, 1998, the Company had placed the outstanding advances under the revolving credit facility under fixed rate loans based on LIBOR at an average rate of approximately 7.6% per annum. In addition, the Company incurs a commitment fee of 0.5% on the unused portion of the borrowing base depending upon the utilization of the available borrowing base. The Bank Credit Facility matures on December 9, 2002. Significant financial covenants under the Bank Credit Facility include the maintenance of a current ratio, as defined, (0.75 to 1.0), maintenance of tangible net worth (\$98.0 million), maintenance of an interest coverage ratio (2.5 to 1), and a limitation on capital expenditures (\$30.0 million).

Based on the scheduled borrowing base reductions in 1999, the Company has classified \$38.0 million of the amount outstanding under the Bank Credit Facility as a current liability at December 31, 1998. The Company plans to reduce its drilling expenditures in 1999 as compared to 1998 and utilize cash flow generated from operations to reduce outstanding borrowings under the Bank Credit Facility. The Company believes that it will generate sufficient operating cash flow during 1999 to reduce the amounts outstanding under the Bank

Credit Facility in accordance with the scheduled reductions to the borrowing base. The Company intends to refinance the additional \$20.0 million reduction to the borrowing base scheduled to occur in January 2000 with a future debt or equity financing or to pay down such debt from proceeds from sale of existing properties. Management cannot be assured that such debt or equity financing will be available for the Company on the terms acceptable to its existing shareholders or that the banks will not require additional reductions to the borrowing base in the future. If oil and gas prices were to fall significantly below current levels for the remainder of 1999 or if the banks were to further reduce the Company's borrowing base, the Company would likely have to complete a debt or equity financing or sell selected properties in order to meet the required 1999 scheduled reductions to its borrowing base.

## **(7) Lease Commitments**

The Company rents office space under certain noncancellable leases. Minimum future payments under the leases are as follows:

	<b>(In thousands)</b>
1999	\$ 389
2000	421
2001	421
2002	421
2003	421

## **(8) Stockholders' Equity**

### *Preferred Stock*

On January 7, 1994, the Company sold 600,000 shares of its Series 1994 Convertible Preferred Stock, \$10 par value per share (the "Series 1994 Preferred"), in a private placement for \$6.0 million. Dividends were payable at the quarterly rate of \$0.225 on each outstanding share of the Series 1994 Preferred (9% per annum of the par value). On September 16, 1996, the holders of the Series 1994 Preferred converted all of the shares of the Series 1994 Preferred into 1,500,000 shares of common stock of the Company.

On July 22, 1994, the Company issued 1,000,000 shares of its 1994 Series B Convertible Preferred Stock, \$10 par value per share (the "1994 Series B Preferred"), in connection with the repurchase of certain production payments previously conveyed by the Company to a major natural gas company. Dividends were payable at the quarterly rate of \$0.15625 on each outstanding share (6.25% per annum of the par value). On July 11, 1996, the Company redeemed the 1,000,000 shares of the 1994 Series B Preferred by issuing 2,000,000 shares of common stock of the Company.

On June 19, 1995, the Company sold 1,500,000 shares of its Series 1995 Convertible Preferred Stock, \$10 par value per share (the "Series 1995 Preferred"), in a private placement for \$15.0 million. Dividends were payable at the quarterly rate of \$0.225 on each outstanding share (9% per annum of the par value). On December 2, 1996, holders of 793,677 shares of the Series 1995 Preferred converted their preferred shares into 1,511,761 shares of common stock of the Company. On August 20, 1997, the holders of the Series 1995 Preferred converted all of the remaining shares of the Series 1995 Preferred, \$10 par value, into 1,345,373 shares of common stock of the Company.

### *Common Stock*

Under a plan adopted by the Board of Directors, non-employee directors can elect to receive shares of common stock valued at the then current market price in payment of annual director and consulting fees. Under this plan, the Company issued 37,117, 9,256 and 39,678 shares of common stock in 1996, 1997, 1998

respectively, in payment of fees aggregating \$154,000, \$113,000 and \$263,000 for 1996, 1997 and 1998, respectively. Shares issued in 1998 also prepaid the director and consulting fees for 1999.

Each of the Company's formerly outstanding preferred stock series provided that the Company could issue common stock in lieu of cash for payment of quarterly dividends. The Company issued 249,453 shares of common stock in 1996 in payment of dividends on its preferred stock of \$1,320,000.

On December 2, 1996, the Company completed a public offering of 5,795,000 shares of common stock of which 4,000,000 (4,869,250 including the over-allotment option which was exercised on December 12, 1996) shares were sold by the Company and 1,795,000 shares were sold by certain stockholders. Net proceeds to the Company, after the underwriting discount and other expenses, were approximately \$57.0 million and were used to reduce indebtedness under the Bank Credit Facility.

On August 20, 1997, the Company repurchased the 1,345,373 shares of common stock held by former Series 1995 Preferred stockholders at \$12.00 per share for an aggregate purchase price of \$16.1 million.

Options and warrants to purchase common stock of the Company were exercised for 1,007,177 shares, 98,100 shares and 102,000 shares in 1996, 1997 and 1998, respectively. Such exercises yielded net proceeds to the Company of approximately \$3.6 million, \$507,000 and \$288,000 in 1996, 1997 and 1998, respectively.

### *Stock Options and Warrants*

On July 16, 1991, the Company's stockholders approved the 1991 Long-Term Incentive Plan (the "Incentive Plan") for the Company's management including officers, directors and managerial employees. The Incentive Plan authorizes the grant of non-qualified stock options and incentive stock options and the grant of restricted stock to key executives of the Company. On May 15, 1996, the Company's stockholders approved an amendment to the Incentive Plan increasing the shares to be awarded by 1,240,000. As of December 31, 1998, the Incentive Plan provided for future awards of stock options or restricted stock grants of up to 228,630 shares of common stock plus 10% of any future issuances of common stock.

The following table summarizes stock option activity during 1996, 1997 and 1998 under the Incentive Plan:

	<b><u>Number of Shares</u></b>	<b><u>Exercise Price</u></b>	<b><u>Weighted Average Exercise Price</u></b>
Outstanding at December 31, 1995	791,750	\$2.00 to \$3.00	\$2.27
Granted	1,933,000	\$4.81 to \$11.00	\$9.31
Exercised	(113,250)	\$2.00 to \$4.81	\$3.06
Forfeited	<u>(10,000)</u>	\$6.56	\$6.56
Outstanding at December 31, 1996	2,601,500	\$2.00 to \$11.00	\$7.45
Granted	667,000	\$9.63 to \$12.38	\$12.00
Exercised	<u>(50,000)</u>	\$3.00 to \$6.56	\$5.33
Outstanding at December 31, 1997	3,218,500	\$2.00 to \$12.38	\$8.43
Granted	767,000	\$3.44 to \$11.94	\$4.57
Exercised	(85,000)	\$2.00 to \$2.50	\$2.38
Forfeited	<u>(10,000)</u>	\$3.44	\$3.44
Outstanding at December 31, 1998	<u>3,890,500</u>	\$2.00 to \$12.38	\$7.81
Exercisable at December 31, 1998	<u>1,839,750</u>	\$2.00 to \$12.38	\$6.76

The following table summarizes information about Incentive Plan stock options outstanding at December 31, 1998:

<u>Exercise Price</u>	<u>Number of Shares Outstanding</u>	<u>Weighted Average Remaining Life (Years)</u>	<u>Number of Shares Exercisable</u>
\$2.00	451,000	2.3	436,500
\$2.50	20,000	3.5	14,000
\$3.00	155,000	1.1	155,000
\$3.44	567,000	8.8	-
\$4.81	264,000	2.6	264,000
\$6.56	250,000	3.1	250,000
\$6.94	150,000	5.0	-
\$9.63	90,000	3.6	90,000
\$11.00	1,326,500	6.6	366,500
\$11.94	40,000	4.9	40,000
\$12.38	<u>577,000</u>	<u>6.5</u>	<u>223,750</u>
	<u>3,890,500</u>	<u>5.5</u>	<u>1,839,750</u>

The Company accounts for the stock options issued under the Incentive Plan under APB Opinion No. 25, under which no compensation cost has been recognized. Had compensation cost for this plan been determined consistent with Statement of Financial Accounting Standards No. 123 ("SFAS 123") "Accounting for Stock-Based Compensation," the Company's net income and earnings per share from continuing operations would have been reduced to the following pro forma amounts:

		<u>1996</u>	<u>1997</u>	<u>1998</u>
<u>(In thousands, except per share amounts)</u>				
Net income (loss) from				
continuing operations:	As Reported	\$ 24,066	\$ 21,746	\$ (17,168)
	Pro Forma	20,296	18,633	(20,651)
Basic earnings per share:	As Reported	1.56	0.90	(0.71)
	Pro Forma	1.31	0.77	(0.85)
Diluted earnings per share:	As Reported	1.23	0.85	
	Pro Forma	0.96	0.72	

Because the SFAS 123 method of accounting has not been applied to options granted prior to January 1, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 1996, 1997, and 1998, respectively: average risk-free interest rates of 6.34, 6.33, and 5.30 percent; average expected lives of 7.7, 7.3, and 8.2 years; average expected volatility factors of 54.5, 51.9 and 58.8; and no dividend yield. The estimated weighted average fair value of options to purchase one share of common stock issued under the Company's Incentive Plan was \$6.20 in 1996, \$7.45 in 1997, and \$2.98 in 1998.

The Company also has options outstanding to purchase 220,530 common shares at \$5.00 per share at December 31, 1998 that were issued in connection with an oil and gas property acquisition in 1994. These options expire in 1999.

On December 8, 1997, the Company awarded warrants to purchase up to 1,000,000 shares of the Company's common stock at \$14.00 per share to Bois d' Arc in connection with a five-year joint exploration venture. The warrants become exercisable in increments of 50,000 shares upon the election by the Company to complete a successful exploration well on a prospect generated by Bois d' Arc under the joint exploration venture. Warrants which become exercisable under the exploration venture expire on December 31, 2007. The fair value of each warrant to purchase one share of common stock is estimated at the date of grant at \$9.97 using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 6.35 percent; expected life of 10.1 years; expected volatility factor of 51.9 percent; and no dividend yield. During 1998, warrants to purchase 150,000 shares became vested. The estimated value of the warrants which vested in 1998 of \$1.5 million was included as exploration costs for three successful wells under the exploration venture.

### ***Restricted Stock Grants***

Under the Incentive Plan, officers and managerial employees of the Company may be granted a right to receive shares of the Company's common stock without cost to the employee. The shares vest over a ten-year period with credit given for past service rendered to the Company. Restricted stock grants for 330,000 shares have been awarded under the Incentive Plan. As of December 31, 1998, 322,500 shares of such awards are vested. A provision for the restricted stock grants is made ratably over the vesting period. Compensation expense recognized for restricted stock grants for the years ended December 31, 1996, 1997 and 1998 was \$41,000, \$15,000, and \$7,000, respectively.

### **(9) Significant Customers**

The Company had sales to one purchaser of crude oil which accounted for 17%, 17%, and 25% of the Company's oil and gas sales in 1996, 1997, and 1998, respectively. In 1996 and 1997, the Company had one purchaser of natural gas which accounted for 31% and 35%, respectively, of the Company's oil and gas sales. In 1998 the Company had two purchasers of natural gas which accounted for 17% and 12% of the Company's oil and gas sales.

### **(10) Income Taxes**

The tax effects of significant temporary differences representing the net deferred tax liability at December 31, 1997 and 1998 were as follows:

	<u>1997</u>	<u>1998</u>
	(In thousands)	
Net deferred tax assets (liabilities):		
Property and equipment	\$ (13,965)	\$ (22,150)
Net operating loss carryforwards	2,193	20,102
Other carryforwards	565	270
Valuation allowance	-	-
	<u>\$ (11,207)</u>	<u>\$ (1,778)</u>

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

	<u>1997</u>	<u>1998</u>
	(In thousands)	
Current	\$ (259)	\$ -
Deferred	<u>(11,363)</u>	<u>9,244</u>
	<u>\$ (11,622)</u>	<u>\$ 9,244</u>



No income tax provision was recognized in 1996 due to the availability of net operating loss carryforwards to offset any current or deferred income tax liabilities.

The difference between income taxes computed using the statutory rate of 35% and the Company's effective tax rate in 1997 and 1998 is as follows:

	<u>1997</u>	<u>1998</u>
	(In thousands)	
Income tax benefit (expense) computed at federal statutory rate	\$ (11,822)	\$ 9,244
Reduction in valuation allowance		
for net operating loss carryforward	176	-
Other	<u>24</u>	<u>-</u>
	<u>\$ (11,622)</u>	<u>\$ 9,244</u>

The Company has net operating loss carryforwards of approximately \$57.4 million as of December 31, 1998 for income tax reporting purposes which expire in varying amounts from 2005 to 2018.

### **(11) Related Party Transactions**

The Company served as general partner of Comstock DR-II Oil & Gas Acquisition Limited Partnership ("Comstock DR-II") until December 29, 1997. In 1996 and 1997, the Company received management fees from Comstock DR-II of \$87,000 and \$40,000, respectively.

From August 1, 1995 to December 1, 1996, the Company was the managing general partner and owned a 20.31% limited partner interest in Crosstex Pipeline Partners, Ltd. ("Crosstex"). The Company sold its interest in connection with the sale of its third party natural gas marketing operations (see Note 13 "Discontinued Operations"). The Company received \$82,000 in fees for management and construction services provided to Crosstex in 1996 and was reimbursed \$228,000 for direct expenses incurred in connection with managing Crosstex in 1996. The Company paid \$477,000 to Crosstex for transportation of its natural gas production in 1996.

### **(12) Risk Management**

The Company's market risk exposures relate primarily to commodity prices and interest rates. Therefore, the Company periodically uses commodity price swaps to hedge the impact of natural gas price fluctuations and uses interest rate swaps to hedge interest rates on floating rate debt. The Company does not engage in activities using complex or highly leveraged instruments. These instruments are generally put in place to limit risk of adverse natural gas price or interest rate movements, however, these instruments usually limit future gains from favorable natural gas prices or lower interest rates. Recognition of realized gains or losses in the Consolidated Statements of Operations are deferred until the underlying physical product is purchased or sold. Unrealized gains or losses on derivative financial instruments are not recorded. The cash flow impact of derivative and other financial instruments is reflected as cash flows from operating activities in the Consolidated Statements of Cash Flows.

As a result of certain hedging transactions for natural gas the Company realized the following gains and losses:

	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(In thousands)		
Realized Gains	\$ 509	\$ -	\$ 367
Realized Losses	1,643	-	-

As of December 31, 1997 and 1998, the Company had no open derivative financial instruments held for price risk management. Subsequent to December 31, 1998, the Company entered into natural gas price swaps covering 10,480,000 MMBtus of its natural gas production for March 1999 to October 1999 at 1,310,000 MMBtus per month at a fixed index price of \$1.81 (after basis adjustment).

The Company entered into interest rate swap agreements in September 1998 to hedge the impact of interest rate changes on a portion of its long-term debt. The notional amount of the swap agreements is \$125.0 million and fixed the LIBOR rate at an average rate of 5.1% through September 2000. Gains and losses attributable to the swap agreements are accounted for as a hedge. Gains from the swap agreements reduced interest expense by \$59,000 in 1998. The fair value of the interest rate swaps as of December 31, 1998 was a liability of approximately \$95,000.

### **(13) Discontinued Operations**

In December 1996, the Company sold its third party natural gas marketing operations and substantially all of its related gas gathering and gas processing assets for approximately \$3.0 million. The Company realized a \$818,000 gain from the sale. The Company's gas gathering, processing and marketing segment is accounted for as discontinued operations in the accompanying financial statements, and accordingly, the results of the gas gathering, processing and marketing operations as well as the gain on disposal are segregated in the accompanying Consolidated Statements of Operations.

Income for discontinued gas gathering, processing and marketing operations included in the Consolidated Statements of Operations for the year ended December 31, 1996 is comprised of the following:

	(In thousands)
Revenues	\$ 85,398
Operating costs	(83,168)
Depreciation, depletion and amortization	(373)
General and administrative, net	(809)
Gain on sales of property	-
Gain on disposal of segment	818
Provision for income taxes	-
Income from discontinued operations	<u>\$ 1,866</u>

#### (14) Supplementary Quarterly Financial Data (Unaudited)

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>Total</u>
	(In thousands, except per share amounts)				
1997 -					
Total revenues .....	<u>\$ 23,727</u>	<u>\$ 18,279</u>	<u>\$ 18,285</u>	<u>\$ 29,053</u>	<u>\$ 89,344</u>
Net income attributable to common stock .....	<u>\$ 7,764</u>	<u>\$ 3,973</u>	<u>\$ 4,190</u>	<u>\$ 5,819</u>	<u>\$ 21,746</u>
Net income per share:					
Basic .....	<u>\$ 0.32</u>	<u>\$ 0.16</u>	<u>\$ 0.17</u>	<u>\$ 0.24</u>	<u>\$ 0.90</u>
Diluted .....	<u>\$ 0.30</u>	<u>\$ 0.16</u>	<u>\$ 0.17</u>	<u>\$ 0.23</u>	<u>\$ 0.85</u>
1998 -					
Total revenues .....	<u>\$ 25,558</u>	<u>\$ 24,894</u>	<u>\$ 21,517</u>	<u>\$ 21,266</u>	<u>\$ 93,235</u>
Net income (loss) attributable to common stock ..	<u>\$ 570</u>	<u>\$ (1,304)</u>	<u>\$ (3,387)</u>	<u>\$ (13,047)</u> (1)	<u>\$ (17,168)</u> (1)
Net income (loss) per share:					
Basic .....	<u>\$ 0.02</u>	<u>\$ (0.05)</u>	<u>\$ (0.14)</u>	<u>\$ (0.54)</u>	<u>\$ (0.71)</u>
Diluted .....	<u>\$ 0.02</u>				

(1) Includes impairment of oil and gas properties of \$17 million.

#### (15) Oil and Gas Reserves Information (Unaudited)

The estimates of proved oil and gas reserves utilized in the preparation of the financial statements were estimated by independent petroleum engineers in accordance with guidelines established by the Securities and Exchange Commission and the Financial Accounting Standards Board, which require that reserve reports be prepared under existing economic and operating conditions with no provision for price and cost escalation except by contractual agreement. All of the Company's reserves are located onshore in or offshore to the continental United States.

Future prices received for production and future production costs may vary, perhaps significantly, from the prices and costs assumed for purposes of these estimates. There can be no assurance that the proved reserves will be developed within the periods indicated or that prices and costs will remain constant. There can be no assurance that actual production will equal the estimated amounts used in the preparation of reserve projections. In accordance with the Securities and Exchange Commission's guidelines, the Company's independent petroleum engineers' estimates of future net cash flows from the Company's proved properties and the present value thereof are made using oil and natural gas sales prices in effect as of the dates of such estimates and are held constant throughout the life of the properties. Average prices used in estimating the future net cash flows were as follows: \$17.24 and \$10.55 per barrel of oil for 1997 and 1998, respectively, and \$2.64 and \$2.21 per Mcf of natural gas for 1997 and 1998, respectively.

There are numerous uncertainties inherent in estimating quantities of proved reserves and in projecting future rates of production and timing of development expenditures. Oil and gas reserve engineering must be recognized as a subjective process of estimating underground accumulations of oil and gas that cannot be measured in an exact way, and estimates of other engineers might differ materially from those shown below. The accuracy of any reserve estimate is a function of the quality of available data and engineering and geological interpretation and judgment. Results of drilling, testing and production after the date of the estimate may justify revisions. Accordingly, reserve estimates are often materially different from the quantities of oil and gas that are ultimately recovered. Reserve estimates are integral in management's analysis of impairments of oil and gas properties and the calculation of depreciation, depletion and amortization on those properties.

The following unaudited table sets forth proved oil and gas reserves at December 31, 1996, 1997 and 1998:

	<u>1996</u>		<u>1997</u>		<u>1998</u>	
	<u>Oil</u> <u>(MBbls)</u>	<u>Gas</u> <u>(MMcf)</u>	<u>Oil</u> <u>(MBbls)</u>	<u>Gas</u> <u>(MMcf)</u>	<u>Oil</u> <u>(Mbbls)</u>	<u>Gas</u> <u>(MMcf)</u>
Proved Reserves:						
Beginning of year	3,779	173,165	8,994	234,444	20,927	240,117
Revisions of previous estimates	243	(5,926)	(1,202)	(7,398)	(3,284)	12,025
Extensions and discoveries	613	551	263	5,566	5,173	24,973
Purchases of minerals in place	5,930	100,446	14,473	39,970	-	-
Sales of minerals in place	(619)	(14,365)	(258)	(9,605)	-	-
Production	<u>(952)</u>	<u>(19,427)</u>	<u>(1,343)</u>	<u>(22,860)</u>	<u>(2,571)</u>	<u>(26,713)</u>
End of year	<u>8,994</u>	<u>234,444</u>	<u>20,927</u>	<u>240,117</u>	<u>20,245</u>	<u>250,402</u>
Proved Developed Reserves:						
Beginning of year	<u>2,562</u>	<u>130,375</u>	<u>6,953</u>	<u>187,247</u>	<u>16,635</u>	<u>188,102</u>
End of year	<u>6,953</u>	<u>187,247</u>	<u>16,635</u>	<u>188,102</u>	<u>16,585</u>	<u>182,955</u>

The following table sets forth the standardized measure of discounted future net cash flows relating to proved reserves at December 31, 1997 and 1998:

	<u>1997</u>	<u>1998</u>
	<u>(In thousands)</u>	
Cash Flows Relating to Proved Reserves:		
Future Cash Flows	\$ 993,812	\$ 767,869
Future Costs:		
Production	(217,637)	(212,558)
Development	<u>(66,418)</u>	<u>(74,130)</u>
Future Net Cash Flows Before Income Taxes	709,757	481,181
Future Income Taxes	<u>(128,983)</u>	<u>(30,221)</u>
Future Net Cash Flows	580,774	450,960
10% Discount Factor	<u>(162,498)</u>	<u>(145,967)</u>
Standardized Measure of Discounted Future Net Cash Flows	<u>\$ 418,276</u>	<u>\$ 304,993</u>

The following table sets forth the changes in the standardized measure of discounted future net cash flows relating to proved reserves for the years ended December 31, 1996, 1997 and 1998:

	<u>1996</u>	<u>1997</u>	<u>1998</u>
	<u>(In thousands)</u>		
Standardized Measure, Beginning of Year	\$ 146,506	\$ 390,422	\$ 418,276
Net Change in Sales Price, Net of Production Costs	132,094	(188,079)	(146,742)
Development Costs Incurred During the Year Which			
Were Previously Estimated	5,934	10,740	20,361
Revisions of Quantity Estimates	(7,612)	(16,779)	(7,391)
Accretion of Discount	14,829	50,292	45,956
Changes in Future Development Costs	(5,801)	(3,919)	(19,318)
Changes in Timing and Other	(13,165)	(20,347)	(39,805)
Extensions and Discoveries	9,216	6,233	60,906
Purchases of Reserves In Place	282,150	205,583	-
Sales of Reserves In Place	(10,342)	(16,450)	-
Sales, Net of Production Costs	(55,077)	(70,636)	(68,214)
Net Changes in Income Taxes	<u>(108,310)</u>	<u>71,216</u>	<u>40,964</u>
Standardized Measure, End of Year	<u>\$ 390,422</u>	<u>\$ 418,276</u>	<u>\$ 304,993</u>

## Corporate Information

### Directors

M. Jay Allison<sup>1,2</sup>  
Richard S. Hickok<sup>2,4</sup>  
Franklin B. Leonard<sup>3,4</sup>  
Cecil E. Martin, Jr.<sup>2,3</sup>  
David W. Sledge<sup>3,4</sup>

<sup>1</sup>Chairman of the Board of Directors

<sup>2</sup>Executive Committee

<sup>3</sup>Compensation Committee

<sup>4</sup>Audit Committee

### Management

M. Jay Allison  
*Chairman of the Board of Directors,  
President and Chief Executive Officer*

Roland O. Burns  
*Senior Vice President,  
Chief Financial Officer,  
Treasurer and Secretary*

Mack D. Good  
*Vice President of Operations*

Stephen E. Neukom  
*Vice President of Marketing*

Richard G. Powers  
*Vice President of Land*

Daniel K. Presley  
*Vice President of Accounting and Controller*

Michael W. Taylor  
*Vice President of Corporate Development*

### Subsidiaries

Comstock Oil & Gas, Inc.  
Comstock Oil & Gas – Louisiana, Inc.  
Comstock Offshore, LLC

### Independent Public Accountants

Arthur Andersen LLP  
Dallas, Texas

### Commercial Banks

The First National Bank of Chicago,  
Administrative Agent  
Toronto Dominion (Texas), Inc.,  
Syndication Agent  
Banque Paribas  
Bank Boston, N.A.  
Christiania Bank OG Kreditkasse, ASA  
Credit Lyonnais  
Meespierson Capital Corporation  
Bank of Scotland  
National Bank of Canada  
Societe Generale

### Annual Meeting

The annual meeting of stockholders will be held on Monday, May 10, 1999 at 4:00 p.m. at the Westin Hotel at the Galleria, 13440 Dallas Parkway, Dallas, Texas. All stockholders are encouraged to attend.

### Investor Relations

Requests for additional information prior to June 1999 should be directed to:

Roland O. Burns  
5005 LBJ Freeway  
Suite 1000  
Dallas, Texas 75244  
(800) 877-1322

Subsequent to June 1999:

5300 Town and Country Blvd.  
Suite 500  
Frisco, Texas 75034  
(800) 877-1322

### Transfer Agent and Registrar

For stock certificate transfers, changes of address or lost stock certificates, please contact:

American Stock Transfer & Trust Company  
40 Wall Street – 46th Floor  
New York, New York 10005  
(800) 937-5449

### Exchange Listing

The Company's common stock is listed for trading on the New York Stock Exchange under the symbol "CRK".



### Stock Market Prices

	1997	
	High	Low
First Quarter	\$14 <sup>3</sup> / <sub>8</sub>	\$8 <sup>1</sup> / <sub>8</sub>
Second Quarter	\$10 <sup>7</sup> / <sub>8</sub>	\$6 <sup>5</sup> / <sub>8</sub>
Third Quarter	\$12 <sup>5</sup> / <sub>8</sub>	\$9 <sup>7</sup> / <sub>8</sub>
Fourth Quarter	\$17 <sup>1</sup> / <sub>2</sub>	\$10 <sup>5</sup> / <sub>8</sub>
	1998	
	High	Low
First Quarter	\$12	\$8 <sup>3</sup> / <sub>4</sub>
Second Quarter	\$13 <sup>1</sup> / <sub>2</sub>	\$7 <sup>5</sup> / <sub>8</sub>
Third Quarter	\$8 <sup>3</sup> / <sub>8</sub>	\$5 <sup>1</sup> / <sub>4</sub>
Fourth Quarter	\$6 <sup>1</sup> / <sub>8</sub>	\$2 <sup>9</sup> / <sub>16</sub>



5005 LBJ Freeway • Suite 1000 • Dallas, Texas 75244 • (972) 701-2000

*Relocating in June 1999 to: 5300 Town and Country Blvd. • Suite 500 • Frisco, Texas 75034 • (972) 668-8800*