

CONTINENTAL RESOURCES INC

Form 10-Q

November 05, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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 Number: 001-32886

CONTINENTAL RESOURCES, INC.

(Exact name of registrant as specified in its charter)

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Oklahoma (State or other jurisdiction of incorporation or organization)	73-0767549 (I.R.S. Employer Identification No.)
302 N. Independence, Suite 1500, Enid, Oklahoma (Address of principal executive offices)	73701 (Zip Code)
Registrant's telephone number, including area code: (580) 233-8955	

Former name, former address and former fiscal year, if changed since last report: Not applicable

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

170,042,442 shares of our \$0.01 par value common stock were outstanding on November 1, 2010.

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When we refer to us, we, our, Company, or Continental we are describing Continental Resources, Inc. and/or our subsidiary.

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Glossary of Crude Oil and Natural Gas Terms

The terms defined in this section are used throughout this report:

Bbl. One stock tank barrel, of 42 U.S. gallons liquid volume, used herein in reference to crude oil, condensate or natural gas liquids.

Boe. Barrels of crude oil equivalent, with six thousand cubic feet of natural gas being equivalent to one barrel of crude oil.

Boepd. Barrels of crude oil equivalent per day.

Bopd. Barrels of crude oil per day.

Completion. The process of treating a drilled well followed by the installation of permanent equipment for the production of natural gas or crude oil, or in the case of a dry hole, the reporting of abandonment to the appropriate agency.

DD&A. Depreciation, depletion, amortization and accretion.

Developed acreage. The number of acres that are allocated or assignable to productive wells or wells capable of production.

Dry hole. Exploratory or development well that does not produce crude oil and natural gas in economically producible quantities.

Enhanced recovery. The recovery of crude oil and natural gas through the injection of liquids or gases into the reservoir. Enhanced recovery methods are often applied when production slows due to depletion of the natural pressure.

Field. An area consisting of a single reservoir or multiple reservoirs all grouped on, or related to, the same individual geological structural feature or stratigraphic condition. The field name refers to the surface area, although it may refer to both the surface and the underground productive formations.

FIFO. (First in/First out) A cost flow assumption where the first (oldest) costs are assumed to flow out first. This means the latest (recent) costs remain on hand.

Formation. A layer of rock which has distinct characteristics that differs from nearby rock.

Horizontal drilling. A drilling technique used in certain formations where a well is drilled vertically to a certain depth and then drilled at a right angle within a specified interval.

Injection well. A well into which liquids or gases are injected in order to push additional crude oil or natural gas out of underground reservoirs and into the wellbores of producing wells. Typically considered an enhanced recovery process.

MBbl. One thousand barrels of crude oil, condensate or natural gas liquids.

MBoe. One thousand Boe.

Mcf. One thousand cubic feet of natural gas.

Mcfd. Mcf per day.

MMBtu. One million British thermal units.

MMcf. One million cubic feet of natural gas.

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NYMEX. The New York Mercantile Exchange.

Play. A portion of the exploration and production cycle following the identification by geologists and geophysicists of areas with potential crude oil and natural gas reserves.

Proved reserves. The quantities of crude oil and natural gas which by analysis of geoscience and engineering data can be estimated with reasonable certainty to be economically producible from a given date forward, from known reservoirs and under existing economic conditions, operating methods, and government regulations prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain.

Proved undeveloped reserves or PUD. Proved 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.

Reservoir. A porous and permeable underground formation containing a natural accumulation of producible crude oil and/or natural gas that is confined by impermeable rock or water barriers and is separate from other reservoirs.

Unit. The joining of all or substantially all interests in a reservoir or field, rather than a single tract, to provide for development and operation without regard to separate property interests. Also, the area covered by a unitization agreement.

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Cautionary Statement Regarding Forward-Looking Statements

Certain statements and information in this report may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, included in this report are forward-looking statements. When used in this report, the words could, believe, anticipate, intend, estimate, expect, project and similar expressions are intended to forward-looking statements, although not all forward-looking statements contain such identifying words. Forward-looking statements are based on the Company's current expectations and assumptions about future events and are based on currently available information as to the outcome and timing of future events. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements described under the heading Item 1A. Risk Factors included in this report and in our Annual Report on Form 10-K for the year ended December 31, 2009.

These forward-looking statements reflect management's current belief, based on currently available information, as to the outcome and timing of future events. Without limiting the generality of the foregoing, certain statements incorporated by reference, if any, or included in this report constitute forward-looking statements.

Forward-looking statements may include statements about our:

business strategy;

future operations;

reserves;

technology;

financial strategy;

crude oil and natural gas prices;

timing and amount of future production of crude oil and natural gas;

the amount, nature and timing of capital expenditures;

estimated revenues and results of operations;

drilling of wells;

competition and government regulations;

marketing of crude oil and natural gas;

exploitation or property acquisitions;

costs of exploiting and developing our properties and conducting other operations;

financial position;

general economic conditions;

credit markets;

liquidity and access to capital;

uncertainty regarding our future operating results; and

plans, objectives, expectations and intentions contained in this report that are not historical.

We caution you that these forward-looking statements are subject to all of the risks and uncertainties, most of which are difficult to predict and many of which are beyond our control, incident to the exploration for and development, production, and sale of crude oil and natural gas. These risks include, but are not limited to, commodity price volatility, inflation, lack of availability of drilling and production equipment and services, environmental risks, drilling and other operating risks, regulatory changes, the uncertainty inherent in estimating crude oil and natural gas reserves and in projecting future rates of production, cash flows and access to capital, the timing of development expenditures, and the other risks described under Item 1A. Risk Factors in this report, our Annual Report on Form 10-K for the year ended December 31, 2009, registration statements filed from time to time with the SEC, and other announcements we make from time to time.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. Should one or more of the risks or uncertainties described in this report occur, or should underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements. All forward-looking statements are expressly qualified in their entirety by this cautionary statement. This cautionary statement should also be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue.

Except as otherwise required by applicable law, we disclaim any duty to update any forward-looking statements, all of which are expressly qualified by the statements in this section, to reflect events or circumstances after the date of this report.

Table of Contents**PART I. Financial Information****ITEM 1. Financial Statements****Continental Resources, Inc. and Subsidiary****Condensed Consolidated Balance Sheets**

<i>In thousands, except par values and share data</i>	September 30, 2010 (Unaudited)	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 149,477	\$ 14,222
Receivables:		
Oil and natural gas sales	162,299	119,565
Affiliated parties	11,885	7,823
Joint interest and other, net	202,144	55,970
Derivative assets	34,849	2,218
Inventories	31,056	26,711
Deferred and prepaid taxes	15	4,575
Prepaid expenses and other	6,295	4,944
Total current assets	598,020	236,028
Net property and equipment, based on successful efforts method of accounting	2,703,867	2,068,055
Debt issuance costs, net	28,076	10,844
Noncurrent derivative assets	4,662	
Total assets	\$ 3,334,625	\$ 2,314,927
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable trade	\$ 313,348	\$ 91,248
Revenues and royalties payable	95,505	66,789
Payables to affiliated parties	2,804	9,612
Accrued liabilities and other	112,888	49,601
Current portion of asset retirement obligations	2,761	2,460
Total current liabilities	527,306	219,710
Long-term debt	895,917	523,524
Other noncurrent liabilities:		
Deferred income tax liabilities	593,161	489,241
Asset retirement obligations, net of current portion	49,718	47,707
Noncurrent derivative liabilities	13,438	
Other noncurrent liabilities	6,334	4,466
Total other noncurrent liabilities	662,651	541,414
Commitments and contingencies (Note 8)		
Shareholders equity:		
Preferred stock, \$0.01 par value; 25,000,000 shares authorized; no shares issued and outstanding		

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Common stock, \$0.01 par value; 500,000,000 shares authorized; 170,099,358 shares issued and outstanding at September 30, 2010; 169,968,471 shares issued and outstanding at December 31, 2009	1,701	1,700
Additional paid-in-capital	435,471	430,283
Retained earnings	811,579	598,296
Total shareholders' equity	1,248,751	1,030,279
Total liabilities and shareholders' equity	\$ 3,334,625	\$ 2,314,927

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**Continental Resources, Inc. and Subsidiary****Unaudited Condensed Consolidated Statements of Income**

<i>In thousands, except per share data</i>	Three months ended September 30, Nine months ended September 30,			
	2010	2009	2010	2009
Revenues:				
Oil and natural gas sales	\$ 232,662	\$ 162,465	\$ 651,925	\$ 389,310
Oil and natural gas sales to affiliates	6,164	5,907	23,451	18,069
Gain (loss) on mark-to-market derivative instruments	(24,183)	(2,105)	57,626	(1,215)
Oil and natural gas service operations	4,807	3,937	14,684	12,409
Total revenues	219,450	170,204	747,686	418,573
Operating costs and expenses:				
Production expenses	23,626	17,536	64,044	56,269
Production expenses to affiliates	1,231	5,183	5,762	12,914
Production taxes and other expenses	19,517	12,378	53,755	30,829
Exploration expenses	3,530	1,077	7,585	9,726
Oil and natural gas service operations	4,935	2,326	12,982	7,423
Depreciation, depletion, amortization and accretion	62,918	51,030	174,327	154,875
Property impairments	14,698	11,791	49,387	70,491
General and administrative expenses	12,148	10,049	35,491	29,684
(Gain) loss on sale of assets	491	(452)	(32,855)	(673)
Total operating costs and expenses	143,094	110,918	370,478	371,538
Income from operations	76,356	59,286	377,208	47,035
Other income (expense):				
Interest expense	(12,612)	(4,763)	(32,875)	(14,073)
Other	237	194	1,021	642
	(12,375)	(4,569)	(31,854)	(13,431)
Income before income taxes	63,981	54,717	345,354	33,604
Provision for income taxes	24,904	19,788	132,071	11,780
Net income	\$ 39,077	\$ 34,929	\$ 213,283	\$ 21,824
Basic net income per share	\$ 0.23	\$ 0.21	\$ 1.26	\$ 0.13
Diluted net income per share	\$ 0.23	\$ 0.21	\$ 1.26	\$ 0.13

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**Continental Resources, Inc. and Subsidiary****Condensed Consolidated Statements of Shareholders Equity**

<i>In thousands, except share data</i>	Shares outstanding	Common Stock	Additional paid-in Capital	Retained earnings	Total shareholders Equity
Balance, January 1, 2009	169,558,129	\$ 1,696	\$ 420,054	\$ 526,958	\$ 948,708
Net income				71,338	71,338
Stock-based compensation			11,408		11,408
Tax benefit on stock-based compensation plan			2,872		2,872
Stock options:					
Exercised	138,010	1	244		245
Repurchased and canceled	(29,924)		(1,223)		(1,223)
Restricted stock:					
Issued	411,217	4			4
Repurchased and canceled	(83,457)	(1)	(3,072)		(3,073)
Forfeited	(25,504)				
Balance, December 31, 2009	169,968,471	\$ 1,700	\$ 430,283	\$ 598,296	\$ 1,030,279
Net income (unaudited)				213,283	213,283
Stock-based compensation (unaudited)			8,596		8,596
Stock options:					
Exercised (unaudited)	199,250	2	249		251
Repurchased and canceled (unaudited)	(57,397)	(1)	(2,540)		(2,541)
Restricted stock:					
Issued (unaudited)	60,667	1			1
Repurchased and canceled (unaudited)	(23,684)		(1,117)		(1,117)
Forfeited (unaudited)	(47,949)	(1)			(1)
Balance, September 30, 2010 (unaudited)	170,099,358	\$ 1,701	\$ 435,471	\$ 811,579	\$ 1,248,751

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**Continental Resources, Inc. and Subsidiary****Unaudited Condensed Consolidated Statements of Cash Flows**

<i>In thousands</i>	Nine months ended September 30,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 213,283	\$ 21,824
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, amortization and accretion	173,321	157,696
Property impairments	49,387	70,491
Change in fair value of derivatives	(28,162)	1,215
Stock-based compensation	8,596	8,594
Provision for deferred income taxes	116,165	11,780
Dry hole costs	1,943	5,002
Gain on sale of assets	(32,855)	(673)
Other, net	3,631	1,726
Changes in assets and liabilities:		
Accounts receivable	(192,970)	70,518
Inventories	(4,345)	(13,038)
Prepaid expenses and other	2,105	21,193
Accounts payable trade	99,869	(115,194)
Revenues and royalties payable	28,716	(22,465)
Accrued liabilities and other	54,008	(4,275)
Other noncurrent liabilities	2,648	1,601
Net cash provided by operating activities	495,340	215,995
Cash flows from investing activities:		
Exploration and development	(719,843)	(372,284)
Purchase of oil and natural gas properties	(7,319)	(1,217)
Purchase of other property and equipment	(20,453)	(4,682)
Proceeds from sale of assets	38,662	2,762
Net cash used in investing activities	(708,953)	(375,421)
Cash flows from financing activities:		
Revolving credit facility borrowings	289,000	372,100
Repayment of revolving credit facility	(515,000)	(502,500)
Proceeds from issuance of Senior Notes	587,210	297,480
Debt issuance costs	(8,932)	(9,826)
Repurchase of equity grants	(3,658)	(717)
Dividends to shareholders	(3)	(8)
Exercise of stock options	251	141
Other debt		2,822
Net cash provided by financing activities	348,868	159,492
Net change in cash and cash equivalents	135,255	66
Cash and cash equivalents at beginning of period	14,222	5,229
Cash and cash equivalents at end of period	\$ 149,477	\$ 5,295

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**Continental Resources, Inc. and Subsidiary****Notes to Unaudited Condensed Consolidated Financial Statements*****Note 1. Organization and Nature of Business****Description of Company*

Continental Resources, Inc.'s principal business is crude oil and natural gas exploration, development and production. Continental's operations are in the North, South, and East regions of the United States. The North region consists of properties north of Kansas and west of the Mississippi river and includes North Dakota Bakken, Montana Bakken, the Red River units and the Niobrara play in Colorado and Wyoming. The South region includes Kansas and all properties south of Kansas and west of the Mississippi river including the Arkoma Woodford and Anadarko Woodford plays in Oklahoma. The East region contains properties east of the Mississippi river including the Illinois Basin and Michigan.

Note 2. Basis of Presentation and Significant Accounting Policies*Basis of presentation*

Continental has one wholly owned subsidiary, Banner Pipeline Company, L.L.C., which has no assets or operations. The consolidated financial statements include the accounts of Continental and its wholly owned subsidiary after all significant inter-company accounts and transactions have been eliminated.

This report has been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) applicable to interim financial information. Because this is an interim period filing presented using a condensed format, it does not include all of the disclosures required by accounting principles generally accepted in the United States (U.S. GAAP), although the Company believes that the disclosures are adequate to make the information not misleading. You should read this Form 10-Q along with the Company's Annual Report on Form 10-K for the year ended December 31, 2009 (2009 Form 10-K), which includes a summary of the Company's significant accounting policies and other disclosures.

The financial statements as of September 30, 2010 and for the three and nine month periods ended September 30, 2010 and 2009 are unaudited. The Condensed Consolidated Balance Sheet as of December 31, 2009 was derived from the audited balance sheet filed in the 2009 Form 10-K. The Company has evaluated events or transactions through the date this report on Form 10-Q was filed in conjunction with its preparation of these financial statements.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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. The most significant of the estimates and assumptions that affect reported results is the estimate of the Company's crude oil and natural gas reserves, which is used to compute depreciation, depletion, amortization and impairment on producing crude oil and natural gas properties. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation in accordance with U.S. GAAP have been included in these unaudited interim condensed consolidated financial statements. The results of operations for any interim period are not necessarily indicative of the results of operations that may be expected for any other interim period or for the entire year.

Inventories

Inventories are stated at the lower of cost or market. Inventories consist of the following:

<i>In thousands</i>	September 30, 2010	December 31, 2009
Tubular goods and equipment	\$ 18,038	\$ 12,044
Crude oil	13,018	14,667

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	\$	31,056	\$	26,711
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Crude oil inventories consist of the following volumes:

<i>In barrels</i>	September 30, 2010	December 31, 2009
Crude oil line fill requirements	229,000	253,000
Temporarily stored crude oil	75,000	145,000
	304,000	398,000

Crude oil inventories, including line fill, are valued at the lower of cost or market using the FIFO inventory method.

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Basic earnings per common share is computed by dividing net income by the weighted-average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilution of non-vested restricted stock awards and dilutive stock options, which are calculated using the treasury stock method as if these awards and options were exercised. The following is the calculation of basic and diluted weighted average shares outstanding and net income per share for the three and nine months ended September 30, 2010 and 2009:

<i>In thousands, except per share data</i>	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Income (numerator):				
Net income - basic and diluted	\$ 39,077	\$ 34,929	\$ 213,283	\$ 21,824
Weighted average shares (denominator):				
Weighted average shares - basic	168,925	168,516	168,889	168,492
Restricted shares	740	782	719	489
Employee stock options	284	408	296	418
Weighted average shares - diluted	169,949	169,706	169,904	169,399
Net income per share:				
Basic	\$ 0.23	\$ 0.21	\$ 1.26	\$ 0.13
Diluted	\$ 0.23	\$ 0.21	\$ 1.26	\$ 0.13

Reclassifications

Certain prior year amounts have been reclassified on the condensed consolidated financial statements to conform to the 2010 presentation. On the condensed consolidated balance sheet as of December 31, 2009, the line item *Derivative assets* was included in *Receivables* *Joint interest and other, net* and has been shown separately in this report to conform to the 2010 presentation. On the unaudited condensed consolidated statement of cash flows for the nine months ended September 30, 2009, the line item *Gain on sale of assets* was included in *Other, net* and has been shown separately in this report to conform to the 2010 presentation.

Note 3. Related Party Transactions

During the second quarter of 2010, the Company determined that a related party relationship, as defined by SEC rules and U.S. GAAP, did not exist with a third party entity that had been historically accounted for as a related party in the consolidated financial statements. Effective April 1, 2010, transactions with this entity are no longer reflected as affiliate transactions in the unaudited condensed consolidated financial statements. The balance sheet at December 31, 2009 includes \$0.1 million from this party in *Receivables* *Affiliated parties* and \$6.4 million in *Payables to affiliated parties*. *Production expenses to affiliates* includes \$1.8 million in expenses from this party for the nine months ended September 30, 2010, all of which was recognized in the first quarter of the year, and \$1.7 million and \$6.4 million in expenses from this party for the three and nine months ended September 30, 2009, respectively.

Note 4. Supplemental Cash Flow Information

The following table discloses supplemental cash flow information about cash paid for interest and income taxes. Also disclosed is information about investing activities that affects recognized liabilities but does not result in cash receipts or payments.

<i>In thousands</i>	Nine months ended September 30,	
	2010	2009
Supplemental cash flow information:		
Cash paid for interest	\$ 17,218	\$ 13,675
Cash paid for income taxes	\$ 10,876	\$ 146

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Cash received for income tax refunds	\$	(1,288)	\$	(22,018)
Non-cash investing activities				
Asset retirement obligations	\$	1,325	\$	555

Note 5. Derivative Contracts

The Company is required to recognize all derivative instruments on the balance sheet as either assets or liabilities measured at fair value. The Company elects not to designate its derivatives as cash flow hedges and as a result marks its derivative instruments to fair value and recognizes the realized and unrealized changes in fair value on derivative instruments in the consolidated statements of income under the caption Gain (loss) on mark-to-market derivative instruments.

The Company has utilized swap and collar derivative contracts to hedge against the variability in cash flows associated with the forecasted sale of future crude oil and natural gas production. While the use of these derivative instruments limits the downside risk of adverse price movements, their use also may limit future revenues from favorable price movements.

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During the nine months ended September 30, 2010, the Company entered into several new swap and collar derivative contracts covering a portion of its crude oil and natural gas production for 2010, 2011, 2012 and 2013. The new contracts were entered into in the n