BARNWELL INDUSTRIES INC
Form 10-Q
August 12, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2008

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number 1-5103

BARNWELL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**72-0496921**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1100 Alakea Street, Suite 2900, Honolulu, Hawaii	**96813**
(Address of principal executive offices)	(Zip code)

(808) 531-8400

(Registrant s telephone number, including area code)

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. x Yes o 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 o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

Act). o Yes x No

As of August 8, 2008 there were 8,269,460 shares of common stock, par value $0.50, outstanding.

BARNWELL INDUSTRIES, INC.

AND SUBSIDIARIES

INDEX

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30, 2008	September 30, 2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	**$ 15,827,000**	$ 10,107,000
Accounts receivable, net of allowance for doubtful accounts of:		
$623,000 at June 30, 2008 and $20,000 at September 30, 2007	**9,921,000**	7,131,000
Deferred income taxes	**1,953,000**	2,171,000
Current taxes receivable		1,040,000
Other current assets	**1,628,000**	1,030,000
TOTAL CURRENT ASSETS	**29,329,000**	21,479,000
DEPOSITS ON RESIDENTIAL PARCELS	**200,000**	800,000
RESIDENTIAL LOTS UNDER DEVELOPMENT	**7,837,000**	5,009,000
INVESTMENT IN RESIDENTIAL PARCELS	**4,983,000**	2,383,000
INVESTMENT IN JOINT VENTURES	**2,770,000**	2,765,000
INVESTMENT IN LAND INTERESTS	**1,450,000**	1,450,000
PROPERTY AND EQUIPMENT	**211,278,000**	202,342,000
ACCUMULATED DEPRECIATION, DEPLETION, AND AMORTIZATION	**(119,899,000)**	(111,663,000)
PROPERTY AND EQUIPMENT, NET	**91,379,000**	90,679,000
TOTAL ASSETS	**$ 137,948,000**	$ 124,565,000
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	**$ 5,278,000**	$ 5,983,000
Accrued capital expenditures	**5,458,000**	2,774,000
Accrued stock appreciation rights	**1,106,000**	1,672,000
Accrued incentive plan costs	**1,669,000**	2,029,000
Other accrued compensation costs	**3,651,000**	3,228,000
Drilling advances	**2,194,000**	1,407,000
Payable to joint interest owners	**1,955,000**	1,123,000
Income taxes payable	**2,024,000**	-

Current portion of long-term debt		**544,000**		354,000
Other current liabilities		**3,045,000**		2,160,000
TOTAL CURRENT LIABILITIES		**26,924,000**		20,730,000
LONG-TERM DEBT		**25,799,000**		22,104,000
LIABILITY FOR RETIREMENT BENEFITS		**2,170,000**		2,387,000
ASSET RETIREMENT OBLIGATION		**5,018,000**		4,734,000
DEFERRED INCOME TAXES		**17,007,000**		19,299,000
MINORITY INTEREST		**1,166,000**		707,000
STOCKHOLDERS EQUITY:				
Common stock, par value $0.50 per share; Authorized, 20,000,000 shares:				
8,393,060 issued at June 30, 2008,				
8,280,060 issued at September 30, 2007		**4,197,000**		4,140,000
Additional paid-in capital		**1,070,000**		738,000
Retained earnings		**52,287,000**		44,988,000
Accumulated other comprehensive income, net		**4,179,000**		4,933,000
Treasury stock, at cost:				
123,600 shares at June 30, 2008,				
11,900 shares at September 30, 2007		**(1,869,000)**		(195,000)
TOTAL STOCKHOLDERS EQUITY		**59,864,000**		54,604,000
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	**$**	**137,948,000**	$	124,565,000

See Notes to Condensed Consolidated Financial Statements

Table of Contents

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	**2008**	2007
Revenues:				
Oil and natural gas	**$ 14,646,000**	$ 9,342,000	**$ 36,239,000**	$ 26,370,000
Contract drilling	**2,674,000**	1,747,000	**7,267,000**	4,092,000
Sale of interest in leasehold land, net	**402,000**	402,000	**1,111,000**	2,619,000
Sale of development rights, net	**1,664,000**	-	**4,161,000**	2,292,000
Gas processing and other	**970,000**	322,000	**1,545,000**	871,000
	20,356,000	11,813,000	**50,323,000**	36,244,000
Costs and expenses:				
Oil and natural gas operating	**2,607,000**	2,576,000	**7,539,000**	7,407,000
Contract drilling operating	**2,166,000**	1,579,000	**5,943,000**	3,677,000
General and administrative	**4,193,000**	2,300,000	**10,476,000**	8,250,000
Bad debt expense	**608,000**	-	**608,000**	-
Depreciation, depletion and amortization	**3,730,000**	3,373,000	**11,109,000**	9,762,000
Interest expense	**257,000**	282,000	**834,000**	738,000
Minority interest in earnings	**486,000**	39,000	**1,045,000**	903,000
	14,047,000	10,149,000	**37,554,000**	30,737,000
Earnings before income taxes	**6,309,000**	1,664,000	**12,769,000**	5,507,000
Income tax provision	**2,776,000**	921,000	**4,232,000**	2,392,000
NET EARNINGS	**$ 3,533,000**	$ 743,000	**$ 8,537,000**	$ 3,115,000
BASIC NET EARNINGS PER COMMON SHARE	**$ 0.43**	$ 0.09	**$ 1.04**	$ 0.38
DILUTED NET EARNINGS PER COMMON SHARE	**$ 0.42**	$ 0.09	**$ 1.01**	$ 0.36
WEIGHTED-AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:				
BASIC	**8,269,460**	8,224,605	**8,242,311**	8,196,030
DILUTED	**8,438,038**	8,613,386	**8,447,209**	8,630,606

See Notes to Condensed Consolidated Financial Statements

Table of Contents

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine months ended June 30, 2008	2007
Cash flows from operating activities:		
Net earnings	**$ 8,537,000**	$ 3,115,000
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation, depletion, and amortization	**11,109,000**	9,762,000
Minority interest in earnings	**1,045,000**	903,000
Bad debt expense	**608,000**	-
Retirement benefits expense	**360,000**	375,000
Accretion of asset retirement obligation	**206,000**	176,000
Asset retirement obligation payments	**(48,000)**	(109,000)
Share-based compensation (benefit) expense	**(87,000)**	1,042,000
Retirement benefits contribution	**(450,000)**	-
Share-based compensation payments	**(458,000)**	(2,024,000)
Deferred income tax (benefit) expense	**(1,332,000)**	746,000
Additions to residential lots under development	**(2,760,000)**	(4,835,000)
Sale of interest in leasehold land, net	**(1,111,000)**	(2,619,000)
Sale of development rights, net	**(4,161,000)**	(2,292,000)
Increase (decrease) from changes in current assets and liabilities	**1,439,000**	(974,000)
Net cash provided by operating activities	**12,897,000**	3,266,000
Cash flows from investing activities:		
Proceeds from sale of development rights, net of fees paid	**4,161,000**	2,292,000
Proceeds from sale of interest in leasehold land, net of fees paid	**1,085,000**	2,619,000
Proceeds from gas over bitumen royalty adjustments	**166,000**	160,000
Return of capital distribution from joint venture	**-**	525,000
Purchase of lot acquisition rights	**-**	(1,400,000)
Deposits on residential parcels	**-**	(1,000,000)
Investment in joint ventures	**(5,000)**	(3,290,000)
Capital expenditures - oil and gas	**(9,939,000)**	(13,223,000)
Capital expenditures - all other	**(708,000)**	(494,000)
Additions to investment in residential parcels	**(222,000)**	-
Net cash used in investing activities	**(5,462,000)**	(13,811,000)
Cash flows from financing activities:		
Proceeds from long-term debt borrowings	**2,264,000**	7,168,000
Proceeds from exercise of stock options	**145,000**	168,000
Contributions from minority interest partner	**-**	558,000
Payment of loan commitment fee	**(100,000)**	-
Repayments of long-term debt	**(121,000)**	(25,000)
Distributions to minority interest partners	**(968,000)**	(912,000)
Payment of dividends	**(1,238,000)**	(1,639,000)
Purchases of common stock for treasury	**(1,596,000)**	-

Net cash (used in) provided by financing activities		**(1,614,000)**		5,318,000
Effect of exchange rate changes on cash and cash equivalents		**(101,000)**		(128,000)
Net increase (decrease) in cash and cash equivalents		**5,720,000**		(5,355,000)
Cash and cash equivalents at beginning of period		**10,107,000**		11,972,000
Cash and cash equivalents at end of period	**$**	**15,827,000**	$	6,617,000

See Notes to Condensed Consolidated Financial Statements

Table of Contents

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME

Three months ended June 30, 2008 and 2007

(Unaudited)

	Shares Outstanding	Common Stock	Additional Paid-In Capital	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders Equity
Balance at March 31, 2007	8,217,160	$ 4,110,000	$ 261,000		$ 44,669,000	$ 1,810,000	$ (40,000)	$ 50,810,000
Exercise of stock options, 17,500 shares	17,500	8,000	101,000					109,000
Share-based compensation costs			17,000					17,000
Dividends declared, $0.05 per share					(412,000)			(412,000)
Comprehensive income:								
Net earnings				$ 743,000	743,000			743,000
Other comprehensive income foreign currency translation adjustments, net of $1,797,000 of taxes				2,329,000		2,329,000		2,329,000
Total comprehensive income				$ 3,072,000				
At June 30, 2007	8,234,660	$ 4,118,000	$ 379,000		$ 45,000,000	$ 4,139,000	$ (40,000)	$ 53,596,000
Balance at March 31, 2008	8,269,460	$ 4,197,000	$ 1,003,000		$ 49,168,000	$ 3,815,000	$ (1,869,000)	$ 56,314,000
Share-based compensation costs			7,000					7,000
Tax benefit from employee stock option transactions			60,000					60,000
Dividends declared, $0.05 per share					(414,000)			(414,000)
Comprehensive income:								
Net earnings				$ 3,533,000	3,533,000			3,533,000
Other comprehensive income:								
Foreign currency translation adjustments, net of $146,000 of taxes				337,000		337,000		337,000

Retirement plans amortization of accumulated other comprehensive loss into net periodic benefit cost, net of $14,000 of taxes				27,000		27,000		27,000
Total comprehensive income				**$ 3,897,000**				
At June 30, 2008	**8,269,460**	**$ 4,197,000**	**$ 1,070,000**		**$ 52,287,000**	**$ 4,179,000**	**$ (1,869,000)**	**$ 59,864,000**

See Notes to Condensed Consolidated Financial Statements

Table of Contents

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME

Nine months ended June 30, 2008 and 2007

(Unaudited)

	Shares Outstanding	Common Stock	Additional Paid-In Capital	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders Equity
Balance at September 30, 2006	8,169,060	$ 4,085,000	$ 144,000		$ 43,524,000	$ 2,852,000	$ -	$ 50,605,000
Exercise of stock options, 67,500 shares net of 1,900 shares tendered and placed in treasury	65,600	33,000	175,000				(40,000)	168,000
Share-based compensation costs			60,000					60,000
Dividends declared, $0.20 per share					(1,639,000)			(1,639,000)
Comprehensive income:								
Net earnings				$ 3,115,000	3,115,000			3,115,000
Other comprehensive income foreign currency translation adjustments, net of $1,220,000 of taxes				1,287,000		1,287,000		1,287,000
Total comprehensive income				$ 4,402,000				
At June 30, 2007	8,234,660	$ 4,118,000	$ 379,000		$ 45,000,000	$ 4,139,000	$ (40,000)	$ 53,596,000
Balance at September 30, 2007	8,268,160	$ 4,140,000	$ 738,000		$ 44,988,000	$ 4,933,000	$ (195,000)	$ 54,604,000
Exercise of stock options, 113,000 shares net of 5,200 shares tendered and placed in treasury	107,800	57,000	166,000				(78,000)	145,000
Share-based compensation costs			28,000					28,000
Tax benefit from employee stock option transactions			138,000					138,000
Purchases of 106,500 common	(106,500)						(1,596,000)	(1,596,000)

shares for treasury								
Dividends declared, $0.15 per share					(1,238,000)			(1,238,000)
Comprehensive income:								
Net earnings				$ 8,537,000	8,537,000			8,537,000
Other comprehensive loss foreign currency translation adjustments, net of $513,000 tax benefit				(837,000)		(837,000)		(837,000)
Other comprehensive income retirement plans amortization of accumulated other comprehensive loss into net periodic benefit cost, net of $43,000 of taxes				83,000		83,000		83,000
Total comprehensive income				**$ 7,783,000**				
At June 30, 2008	**8,269,460**	**$ 4,197,000**	**$ 1,070,000**		**$ 52,287,000**	**$ 4,179,000**	**$ (1,869,000)**	**$ 59,864,000**

See Notes to Condensed Consolidated Financial Statements

Table of Contents

BARNWELL INDUSTRIES, INC.

AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

Basis of Consolidation

The condensed consolidated financial statements include the accounts of Barnwell Industries, Inc. and all majority-owned subsidiaries, including an indirect 77.6%-owned land investment general partnership and two 80%-owned joint ventures (collectively referred to herein as Barnwell, we, our, us, or the Company). All signifi intercompany accounts and transactions have been eliminated. Investments in companies over which Barnwell has the ability to exercise significant influence, but not control, are accounted for using the equity method.

Unless otherwise indicated, all references to dollars in this Form 10-Q are to U.S. dollars.

Unaudited Interim Financial Information

The Condensed Consolidated Balance Sheet as of June 30, 2008, the Condensed Consolidated Statements of Earnings for the three and nine months ended June 30, 2008 and 2007, the Condensed Consolidated Statements of Cash Flows for the nine months ended June 30, 2008 and 2007, and the Condensed Consolidated Statements of Stockholders Equity and Comprehensive Income for the three and nine months ended June 30, 2008 and 2007 have been prepared by Barnwell and are unaudited. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows at June 30, 2008 and for all periods presented have been made. The Condensed Consolidated Balance Sheet as of September 30, 2007 has been derived from audited consolidated financial statements.

Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and notes thereto included in Barnwell s September 30, 2007 Annual Report on Form 10-K. The results of operations for the period ended June 30, 2008 are not necessarily indicative of the operating results for the full year.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management of Barnwell to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results could differ significantly from those estimates.

Significant Accounting Policies

Barnwell s significant accounting policies are described in the Notes to Consolidated Financial Statements included in Item 8 of the Company s most recently filed Annual Report on Form 10-K.

Table of Contents

Reclassifications

Certain reclassifications have been made to the June 30, 2007 condensed consolidated financial statements to conform to classifications used in the June 30, 2008 condensed consolidated financial statements.

2. EARNINGS PER COMMON SHARE

Reconciliations between net earnings and common shares outstanding of the basic and diluted net earnings per share computations for the three and nine months ended June 30, 2008 and 2007 are as follows:

	Three months ended June 30, 2008		
	Net Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic net earnings per share	**$ 3,533,000**	**8,269,460**	**$ 0.43**
Effect of dilutive securities - common stock options	**-**	**168,578**	
Diluted net earnings per share	**$ 3,533,000**	**8,438,038**	**$ 0.42**

	Nine months ended June 30, 2008		
	Net Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic net earnings per share	**$ 8,537,000**	**8,242,311**	**$ 1.04**
Effect of dilutive securities - common stock options	**-**	**204,898**	
Diluted net earnings per share	**$ 8,537,000**	**8,447,209**	**$ 1.01**

	Three months ended June 30, 2007		
	Net Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic net earnings per share	$ 743,000	8,224,605	$ 0.09
Effect of dilutive securities - common stock options	-	388,781	

Diluted net earnings per share	$	743,000	8,613,386	$	0.09

Table of Contents

	Nine months ended June 30, 2007		
	Net Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic net earnings per share	$ 3,115,000	8,196,030	$ 0.38
Effect of dilutive securities - common stock options	-	434,576	
Diluted net earnings per share	$ 3,115,000	8,630,606	$ 0.36

3. SHARE-BASED PAYMENTS

On March 3, 2008, the stockholders of Barnwell approved the 2008 Equity Incentive Plan (the 2008 Plan). Under the 2008 Plan, the Compensation Committee, which consists of independent members of Barnwell s Board of Directors, is authorized to grant incentive stock options, nonstatutory stock options, stock options with stock appreciation rights, restricted stock, restricted stock units and performance units, qualified performance-based awards, and stock grants to employees, consultants and non-employee members of the Board of Directors. 800,000 shares of Barnwell common stock have been reserved for issuance pursuant to the 2008 Plan.

Under Statement of Financial Accounting Standards (SFAS) No. 123(R), share-based compensation cost is measured at fair value. Barnwell utilizes a closed-form valuation model to determine the fair value of each option award. Expected volatilities are based on the historical volatility of Barnwell s stock over a period consistent with that of the expected terms of the options. The expected terms of the options represent expectations of future employee exercise and are estimated based on factors such as vesting periods, contractual expiration dates, historical trends in Barnwell s stock price, and historical exercise behavior. The risk-free rates for periods within the contractual life of the options are based on the yields of U.S. Treasury instruments with terms comparable to the estimated option terms. Expected dividends are based on current and historical dividend payments. Share-based compensation expense recognized in earnings for the three and nine months ended June 30, 2008 and 2007 are reflected in General and administrative expenses in the Condensed Consolidated Statements of Earnings.

The Company s share-based compensation expense (benefit) and related income tax effects are as follows:

	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	**2008**	2007
Share-based compensation	**$ 582,000**	$ 155,000	**$ (87,000)**	$ 1,042,000

expense (benefit)								
Income tax effect - provision (benefit)	**$**	**(198,000)**	$	(46,000)	**$**	**39,000**	$	(338,000)

As of June 30, 2008, there was $1,832,000 of total unrecognized compensation cost related to nonvested equity-classified and liability-classified share options. That cost is expected to be recognized over 3.6 years.

Table of Contents

Total share-based compensation expense related to the vesting of awards in the three and nine months ended June 30, 2008 was $164,000 and $347,000, respectively, as compared to $124,000 and $432,000, respectively, during the same periods of the prior year.

Equity-classified Awards

A summary of the activity in Barnwell s equity-classified share options as of the beginning and end of the three and nine months ended June 30, 2008 is presented below:

Three months ended June 30, 2008

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at April 1, 2008	232,000	$ 7.90		
Granted	-			
Exercised	-			
Forfeited/Expired	-			
Outstanding at June 30, 2008	232,000	$ 7.90	2.7	$ 1,244,000
Exercisable at June 30, 2008	179,500	$ 7.51	2.7	$ 1,033,000

Nine months ended June 30, 2008

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at October 1, 2007	345,000	$ 5.96		
Granted	-			
Exercised	(113,000)	$ 1.98		
Forfeited/Expired	-			
Outstanding at June 30, 2008	232,000	$ 7.90	2.7	$ 1,244,000
Exercisable at June 30, 2008	179,500	$ 7.51	2.7	$ 1,033,000

Total share-based compensation expense for equity-classified awards vested in the three and nine months ended June 30, 2008 was $7,000 and $28,000, respectively, as compared to $17,000 and $60,000 during the three and nine months ended June 30, 2007, respectively. There was no impact on income taxes as the expense relates to qualified options.

The total intrinsic value of equity options exercised during the nine months ended June 30, 2008 was $1,047,000, as compared to $228,000 and $1,178,000 during the three and nine months ended June 30, 2007, respectively. No equity options were exercised during the three months ended June 30, 2008.

Table of Contents

Barnwell recorded tax benefits of $60,000 and $138,000 in the three and nine months ended June 30, 2008, respectively, related to employees disqualification of qualified stock options. The tax benefits are reflected as increases in additional paid-in capital in the three and nine months ended June 30, 2008. There were no tax benefits from disqualification of stock options in the three and nine months ended June 30, 2007.

Liability-classified Awards

In December 2007, Barnwell granted stock options to acquire 100,000 shares of Barnwell s common stock under a non-qualified plan at a purchase price of $12.92 per share (market price on date of grant). The stock options were issued in March 2008 under the 2008 Plan, which received shareholder approval on March 3, 2008. These options vest annually over four years commencing one year from the date of grant and expire in December 2017. These options have stock appreciation rights that permit the holder to receive stock, cash or a combination thereof equal to the amount by which the fair market value, at the time of exercise of the option, exceeds the option price.

In May 2008, Barnwell granted stock options to acquire 240,000 shares of Barnwell s common stock under a non-qualified plan at a purchase price of $11.40 per share (market price on date of grant). The stock options were issued under the 2008 Plan. These options vest annually over four years commencing one year from the date of grant and expire in May 2018. These options have stock appreciation rights that permit the holders to receive stock, cash or a combination thereof equal to the amount by which the fair market value, at the time of exercise of the option, exceeds the option price.

The following assumptions were used in estimating fair value for all liability-classified share options outstanding during the three and nine months ended June 30, 2008 and 2007:

	Three and nine months ended June 30,	
	2008	2007
Expected volatility range	34.9% to 39.5%	32.8% to 36.0%
Weighted-average volatility	36.4%	33.5%
Expected dividends	1.8%	1.0% to 1.2%
Expected term (in years)	6.4 to 9.9	0.9 to 5.0
Risk-free interest rate	3.5% to 4.0%	4.9%
Expected forfeitures	None	None

The application of alternative assumptions could produce significantly different estimates of the fair value of share-based compensation, and consequently, the related costs reported in the Condensed Consolidated Statements of

Earnings.

Table of Contents

A summary of the activity in Barnwell s liability-classified share options as of the beginning and end of the three and nine months ended June 30, 2008 is presented below:

Three months ended June 30, 2008

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at April 1, 2008	296,000	$ 9.35		
Granted	240,000	$ 11.40		
Exercised	(40,000)	$ 2.60		
Forfeited/Expired	-			
Outstanding at June 30, 2008	496,000	$ 10.89	8.7	$ 1,176,000
Exercisable at June 30, 2008	72,000	$ 8.80	6.4	$ 321,000

Nine months ended June 30, 2008

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at October 1, 2007	196,000	$ 7.54		
Granted	340,000	$ 11.85		
Exercised	(40,000)	$ 2.60		
Forfeited/Expired	-			
Outstanding at June 30, 2008	496,000	$ 10.89	8.7	$ 1,176,000
Exercisable at June 30, 2008	72,000	$ 8.80	6.4	$ 321,000

Total share-based compensation for liability-classified awards was a $575,000 expense and a $115,000 benefit for the three and nine months ended June 30, 2008, respectively, as compared to expenses of $138,000 and $982,000 for the three and nine months ended June 30, 2007, respectively. The related income tax effects were a $198,000 benefit and a $39,000 expense for the three and nine months ended June 30, 2008, respectively, and benefits of $46,000 and $338,000 for the three and nine months ended June 30, 2007, respectively. Included in share-based compensation for liability-classified awards for the three and nine months ended June 30, 2008 were $157,000 and $318,000, respectively, of compensation expense related to shares that vested during each respective period and a $418,000 expense and a $433,000 benefit, respectively, due to remeasurement at June 30, 2008 of the fair value of previously vested shares. Included in share-based compensation for liability-classified awards for the three and nine months ended June 30, 2007 were $108,000 and $372,000, respectively, of compensation expense related to shares that vested during each respective period and $30,000 and $610,000, respectively, of compensation expense due to remeasurement at June 30, 2007 of the fair value of previously vested shares.

Table of Contents

In May 2008, the stock appreciation rights feature of 40,000 shares of non-qualified options was exercised and $458,000 was paid in cash by Barnwell. The estimated current tax benefit to be realized for the tax deduction of this exercise is $156,000 for the three and nine months ended June 30, 2008.

4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, demand deposits and short-term investments with original maturities of three months or less.

5. DEPOSITS ON RESIDENTIAL PARCELS, RESIDENTIAL LOTS UNDER DEVELOPMENT AND INVESTMENT IN RESIDENTIAL PARCELS

Kaupulehu 2007, LLLP (Kaupulehu 2007), a Hawaii limited liability limited partnership 80%-owned by Barnwell and 20%-owned by Nearco, Inc., a company controlled by a director of Barnwell and minority interest owner in certain of Barnwell s business ventures (see further discussion on related party interests at Note 8 below), acquires house lots for investment and constructs turnkey single-family homes for future sale.

As of June 30, 2008, Kaupulehu 2007 owns four parcels in the Lot 4A Increment I area located approximately six miles north of the Kona International Airport in the North Kona District of the Island of Hawaii, within and adjacent to the Hualalai Resort at Historic Ka upulehu, between the Queen Kaahumanu Highway and the Pacific Ocean. Kaupulehu 2007 is in the process of developing residences for future sale on two of the parcels and intends to hold the remaining two parcels for investment purposes. The two parcels held for development are classified as Residential Lots Under Development and the other two parcels are classified as Investment in Residential Parcels on the Condensed Consolidated Balance Sheet at June 30, 2008.

In June 2008, Kaupulehu 2007 sold its investments in two of its three remaining rights to purchase lots in the Lot 4A Increment I area to an unrelated party at a price of $221,000 each. The $443,000 gain from the sale of lot purchase rights is reflected in Gas processing and other on the Condensed Consolidated Statements of Earnings for the three and nine months ended June 30, 2008. The unrelated party used the lot purchase rights acquired from Kaupulehu 2007 to purchase two parcels in the Lot 4A Increment I area from WB KD Acquisition, LLC (WB), an entity unrelated to Barnwell. As Kaupulehu 2007 no longer had an obligation to purchase the aforementioned two parcels, Kaupulehu 2007 received a $400,000 refund of its original deposits for the two lots at $200,000 per lot. The deposit refunds were received in July 2008, and thus the deposits are included in Accounts receivable, net on the Condensed Consolidated Balance Sheet at June 30, 2008.

As of June 30, 2008, one deposit of $200,000 remains. This deposit secures Kaupulehu 2007 s right to purchase one parcel in the Lot 4A Increment I area at a price of $2,378,000 from WB. The deposit is classified as Deposits on Residential Parcels on the Condensed Consolidated Balance Sheet at June 30, 2008. The closing date for Kaupulehu 2007 s obligation to purchase the remaining parcel is being negotiated. If Kaupulehu 2007 were to forfeit the deposit on this remaining parcel, Barnwell would incur an expense as a result of the write-off of its 80% share of the forfeited deposit.

Table of Contents

Kaupulehu 2007 has an agreement with Mr. David Johnston, the son of Mr. Terry Johnston, a director of Barnwell, under which Mr. David Johnston serves as Kaupulehu 2007 s project manager. Kaupulehu 2007 also has an agreement with an independent building contractor for home building services for Kaupulehu 2007 s lots. A significant provision of these agreements is that in addition to a monthly fee, Mr. David Johnston and the building contractor will each receive 20% of the sales profit which is contingent on the sale of each of the two homes under construction.

As of the date of this filing, framing is substantially complete for the two residences being developed for resale and roofing work is nearing completion. Interior construction, including electrical and air conditioning, is moving forward on both houses.

6. INVESTMENT IN JOINT VENTURES

Kaupulehu Investors, LLC, a limited liability company 80%-owned by Barnwell and 20%-owned by Nearco, Inc., a company controlled by a director of Barnwell and minority interest owner in certain of Barnwell s business ventures (see further discussion on related party interests at Note 8 below), owns a 1.5% passive minority interest in Hualalai Investors JV, LLC and in Hualalai Investors II, LLC, owners of Hualalai Resort, and Kona Village Investors, LLC, owner of Kona Village Resort. Kaupulehu Investors, LLC, accounts for its 1.5% passive investments under the cost method. These investments are reflected in the Condensed Consolidated Balance Sheets as of June 30, 2008 and September 30, 2007 as Investment in Joint Ventures.

7. INVESTMENT IN LAND INTERESTS

The land interests held by Barnwell at June 30, 2008 through Kaupulehu Developments, a general partnership in which Barnwell has a 77.6% controlling interest, include development rights under option, rights to receive varying percentages of the gross sales from the sale of lots within approximately 870 acres in the Kaupulehu area by WB, and approximately 1,000 acres of vacant leasehold land zoned conservation (Lot 4C) which is under a right of negotiation with WB KD Acquisition II, LLC (WBKD), an unrelated entity. Barnwell also holds lot acquisition rights in agricultural-zoned leasehold land in the upland area of Kaupulehu (Mauka Lands) through Kaupulehu Mauka Investors, LLC, a limited liability company wholly-owned by Barnwell. There is no assurance that any future development rights option payments or percentage of sales payments will be received, nor is there any assurance that WBKD will enter into an agreement with Kaupulehu Developments regarding Lot 4C. Furthermore, there is no assurance that the required land use reclassification and rezoning from regulatory agencies will be obtained nor is there any assurance that the necessary development terms and agreements will be successfully negotiated for the Mauka Lands. If the developer of the Mauka Lands is unable to obtain such required land use changes, development terms and agreements with respect to the Mauka Lands and Barnwell is therefore unable to fully recover its investment in the Mauka Lands, we will incur an expense resulting from a write-off of the lot acquisition rights.

Barnwell s cost of land interests is included in the June 30, 2008 and September 30, 2007 Condensed Consolidated Balance Sheets under the caption Investment in Land Interests and consists of the following amounts:

Table of Contents

		June 30, 2008		September 30, 2007
Leasehold land interests:				
Zoned for resort/residential development Lot 4A Increment I	**$**	**-**	$	-
Zoned for resort/residential development Lot 4A Increment II		**-**		-
Zoned conservation Lot 4C		**50,000**		50,000
		50,000		50,000
Lot acquisition rights Mauka Lands		**1,400,000**		1,400,000
Development rights under option		**-**		-
Total investment in land interests	**$**	**1,450,000**	$	1,450,000

8. RELATED PARTY TRANSACTIONS

This section discusses certain direct and indirect relationships and transactions involving Barnwell and Mr. Terry Johnston, a director of Barnwell and minority interest owner in certain of Barnwell s business ventures.

Mr. Johnston and his affiliated entities own a direct financial interest in 19.3% of Kaupulehu Developments, a general partnership in which Barnwell has a 77.6% controlling interest. The development rights proceeds received during the three and nine months ended June 30, 2008 were reduced by fees of $106,000 and $265,000, respectively, and the percentage of sales payment proceeds received during the three and nine months ended June 30, 2008 were reduced by fees of $26,000 and $71,000, respectively; these fees were payable to Nearco, Inc. (Nearco), a company controlled by Mr. Terry Johnston. A portion of the fees payable was paid to Nearco during the nine months ended June 30, 2008 with the balance paid to Nearco in July 2008. The development rights proceeds received during the nine months ended June 30, 2007 were reduced by fees to Nearco of $146,000, and the percentage of sales payment proceeds received during the three and nine months ended June 30, 2007 were reduced by fees to Nearco of $26,000 and $167,000, respectively; there were no development rights proceeds, and thus no related fees to Nearco, during the three months ended June 30, 2007. Under agreements entered into in 1987, prior to Mr. Johnston s election to Barnwell s Board of Directors, Barnwell s wholly-owned subsidiary, Barnwell Hawaiian Properties, Inc., a 50.1% partner of Kaupulehu Developments, is obligated to pay Nearco 2% of Kaupulehu Developments gross receipts from real estate transactions, and Cambridge Hawaii Limited Partnership, a 49.9% partner of Kaupulehu Developments in which Barnwell purchased a 55.2% interest in April 2001, is obligated to pay Nearco 4% of Kaupulehu Developments gross receipts from real estate transactions. The fees represent compensation for promotion and marketing of Kaupulehu Developments property and were determined at that time based on the estimated fair value of such services.

Barnwell and Nearco entered into a limited liability limited partnership, Kaupulehu 2007, to acquire house lots for investment and to construct turnkey single-family homes. Nearco has a 20% ownership interest in Kaupulehu 2007.

As noted in Note 5 above, Kaupulehu 2007 has an agreement with Mr. David Johnston, the son of Mr. Terry Johnston, under which Mr. David Johnston serves as Kaupulehu 2007 s project manager. A significant provision of this agreement is that in addition to a fixed monthly fee, Mr. David Johnston will receive 20% of the sales profit which is contingent on the sale of each of the two homes under construction. During the three and nine months ended June 30,

Table of Contents

2008, Kaupulehu 2007 paid $32,000 and $62,000, respectively, in project management fees to Nearco for project management services rendered by Mr. David Johnston. No such fees were paid during the three and nine months ended June 30, 2007. These costs are being capitalized as they are project costs associated with the development and construction of a real estate project and are included in Residential Lots Under Development on the Consolidated Balance Sheet at June 30, 2008.

Kaupulehu 2007 has borrowings under a credit facility that is guaranteed jointly and severally by Barnwell and Mr. Terry Johnston, with Mr. Terry Johnston s guarantee limited to 20% (see further discussion regarding the credit facility at Note 9 below).

In September 2007, Nearco made a $525,000 loan to Kaupulehu 2007 to partially fund Kaupulehu 2007 s acquisition of a third residential lot. The loan plus accrued interest, at a floating rate equivalent to the highest interest rate incurred by Kaupulehu 2007 on its bank debt, is payable upon Kaupulehu 2007 s sale of its second completed home. As of June 30, 2008, interest accrued on the Nearco loan totaled $20,000. The loan balance is to be reduced by any contributions to Kaupulehu 2007 by Barnwell that are not matched by Nearco in proportion to its ownership interest in Kaupulehu 2007. During fiscal 2008, Barnwell contributed $1,530,000 to Kaupulehu 2007 that was not matched by Nearco in proportion to its ownership interest in Kaupulehu 2007. This resulted in a $382,000 reduction in Nearco s loan balance to $143,000 and a corresponding increase in the minority interest liability. Kaupulehu 2007 repaid this loan in full in July 2008.

General and administrative expenses include fees paid to Nearco for services related to Kaupulehu Developments leasehold land and Kaupulehu 2007 s residential property. Fees paid to Nearco by Kaupulehu Developments totaled $9,000 and $54,000, before minority interest, in the three and nine months ended June 30, 2008, respectively, and $18,000 and $78,000, before minority interest, in the three and nine months ended June 30, 2007, respectively. Kaupulehu 2007 incurred fees to Nearco of $27,000, before minority interest, in the three and nine months ended June 30, 2008 for professional services rendered in connection with Kaupulehu 2007 s sale of two lot purchase rights to an unrelated party. There were no such fees incurred in the three and nine months ended June 30, 2007.

9. LONG-TERM DEBT

A summary of Barnwell s long-term debt (including the current portion) as of June 30, 2008 and September 30, 2007 is as follows:

	June 30,	September 30,

	2008	2007
Canadian revolving credit facility	**$ 15,399,000**	$ 14,520,000
Real estate revolving credit facility	**9,886,000**	-
Real estate non-revolving credit facility	**428,000**	6,845,000
Related party loan	**143,000**	525,000
Drill rig financing	**487,000**	568,000
Total long-term debt	**$ 26,343,000**	$ 22,458,000

Table of Contents

Barnwell s credit facility at Royal Bank of Canada, a Canadian bank, was renewed in April 2008 for $20,000,000 Canadian dollars, or approximately US$19,634,000 at June 30, 2008 exchange rates. Borrowings under this facility were US$15,399,000 at June 30, 2008 and are included in long-term debt. At June 30, 2008, Barnwell had unused credit available under this facility of approximately US$4,235,000.

The facility is available in U.S. dollars at the London Interbank Offer Rate plus 2.0%, at U.S. prime plus 0.75%, or in Canadian dollars at Canadian prime plus 0.75%. A standby fee of 0.35% per annum is charged on the unused facility balance. Under the financing agreement, the facility is reviewed annually, with the next review planned for April 2009. Subject to that review, the facility may be extended one year with no required debt repayments for one year or converted to a two-year term loan by the bank. The primary focus of the annual review is on the future cash flows that will be generated by Barnwell s Canadian oil and natural gas properties. Additionally, Royal Bank of Canada may adjust the total amount of the credit facility during its next review. If the facility is converted to a two-year term loan, Barnwell has agreed to the following repayment schedule of the then outstanding loan balance: first year of the term period 20% (5% per quarter), and in the second year of the term period 80% (5% per quarter for the first three quarters and 65% in the final quarter). No debt repayments would be required on or before June 30, 2009 if the facility were converted to a two-year term loan. Barnwell has the option to change the currency denomination and interest rate applicable to the loan at periodic intervals during the term of the loan. The facility is collateralized by a general security agreement on all of the assets of Barnwell s oil and natural gas segment. The facility is guaranteed by Barnwell. No compensating bank balances are required for this facility.

Barnwell, through its 80%-owned real estate joint venture, Kaupulehu 2007, obtained a $7,500,000 non-revolving credit facility in fiscal 2007 to finance the acquisition of real estate parcels and a portion of the initial home construction on those parcels. In December 2007, Kaupulehu 2007 refinanced $6,600,000 of the $7,068,000 outstanding borrowings under the facility with a new revolving credit facility from another financial institution. The new facility provides $16,000,000 of credit under a revolving line of credit for the purpose of refinancing the acquisition of three parcels purchased in fiscal 2007, financing the acquisition of a fourth parcel purchased in January 2008, and financing costs of home construction on the said four lots. Under the terms of the facility, financing for home construction is limited to a maximum of two unsold homes under construction at any given time. The term of the loan is 36 months and advances shall not exceed: (i) 75% of the appraised as-is value of each parcel, or (ii) 80% of the appraised value of the completed home and parcel for each home under construction. The interest rate available for borrowings under this facility is a floating rate equal to the financial institution s floating base rate or the one-month London Interbank Offer Rate plus 2.50%. Kaupulehu 2007 will be required to make a principal payment upon the sale of a home and lot in an amount equal to 100% of the net sales proceeds of the home and lot; the loan agreement defines net sales proceeds as the gross sales price of the home and lot, less reasonable real estate commissions, closing costs, and fees of the building contractor and project manager, as approved by the financial institution. The credit facility, which is fully guaranteed by Barnwell and guaranteed 20% by Mr. Terry Johnston, is collateralized by, among other things, a first mortgage lien on the parcels and homes to be built. Kaupulehu 2007 incurred a 1% loan commitment fee totaling $160,000. Borrowings under the facility are subject to a loan advance limitation based on the appraised value of the underlying security. The loan advance limitation may be reduced as a result of a decrease in appraised values of the underlying security. If borrowings under the facility exceed the loan advance limitation, Barnwell will be required to make debt repayments in the amount of the excess.

Table of Contents

At June 30, 2008, Kaupulehu 2007 s borrowings under the revolving credit facility were $9,886,000. The facility expires in December 2010. Accordingly, the $9,886,000 is classified as long-term debt on the Condensed Consolidated Balance Sheet at June 30, 2008. At June 30, 2008, Barnwell had unused credit available under this facility of approximately $6,114,000. The $428,000 portion of the outstanding loan balance under the non-revolving facility that was not refinanced was due October 1, 2008 and was repaid in full in July 2008, and accordingly, is classified as a current liability on the Condensed Consolidated Balance Sheet at June 30, 2008.

Kaupulehu 2007 capitalizes interest costs on residential lots under development while development and construction is in progress and intends to include these costs in cost of sales when homes are sold. Capitalized interest costs totaled $98,000 and $286,000 for the three and nine months ended June 30, 2008, respectively.

As also discussed in Note 8 above, Nearco made a $525,000 loan to Kaupulehu 2007 to partially fund Kaupulehu 2007 s acquisition of a third residential lot in September 2007. The loan plus accrued interest, at a floating rate equivalent to the highest interest rate incurred by Kaupulehu 2007 on its bank debt, is payable upon Kaupulehu 2007 s sale of its second completed home. Barnwell does not expect the sale of the second home to occur on or before June 30, 2009; accordingly, the partner loan is classified as long-term debt on the Condensed Consolidated Balance Sheet at June 30, 2008. The loan balance is to be reduced by any contributions to Kaupulehu 2007 by Barnwell that are not matched by Nearco in proportion to its ownership interest in Kaupulehu 2007. During fiscal 2008, Barnwell contributed $1,530,000 to Kaupulehu 2007 that was not matched by Nearco in proportion to its ownership interest in Kaupulehu 2007. This resulted in a $382,000 reduction in Nearco s loan balance to $143,000 and a corresponding increase in the minority interest liability. Kaupulehu 2007 repaid this loan in full in July 2008.

Interest costs for the three and nine months ended June 30, 2008 and 2007 are summarized as follows:

	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	**2008**	2007
Interest costs incurred	**$ 355,000**	$ 338,000	**$ 1,120,000**	$ 794,000
Less interest costs capitalized on residential lots under development	**98,000**	56,000	**286,000**	56,000
Interest expense	**$ 257,000**	$ 282,000	**$ 834,000**	$ 738,000

10. SEGMENT INFORMATION

Barnwell operates four segments: 1) exploring for, developing, producing and selling oil and natural gas in Canada (oil and natural gas); 2) investment in leasehold land and other real estate interests in Hawaii (land investment); 3) drilling wells and installing and repairing water pumping systems in Hawaii (contract drilling); and 4) acquisition of property for investment and development of homes for sale in Hawaii (residential real estate, established January 2007).

Table of Contents

The following is certain financial information related to Barnwell s reporting segments. All revenues reported are from external customers.

	Three months ended June 30, 2008	Three months ended June 30, 2007	Nine months ended June 30, 2008	Nine months ended June 30, 2007
Revenues:				
Oil and natural gas	**$ 14,646,000**	$ 9,342,000	**$ 36,239,000**	$ 26,370,000
Land investment	**2,066,000**	402,000	**5,272,000**	4,911,000
Contract drilling	**2,674,000**	1,747,000	**7,267,000**	4,092,000
Residential real estate	**443,000**	-	**443,000**	-
Other	**466,000**	160,000	**921,000**	469,000
Total before interest income	**20,295,000**	11,651,000	**50,142,000**	35,842,000
Interest income	**61,000**	162,000	**181,000**	402,000
Total revenues	**$ 20,356,000**	$ 11,813,000	**$ 50,323,000**	$ 36,244,000
Depreciation, depletion and amortization:				
Oil and natural gas	**$ 3,578,000**	$ 3,266,000	**$ 10,682,000**	$ 9,449,000
Contract drilling	**107,000**	57,000	**287,000**	164,000
Other	**45,000**	50,000	**140,000**	149,000
Total depreciation, depletion and amortization	**$ 3,730,000**	$ 3,373,000	**$ 11,109,000**	$ 9,762,000
Operating profit (before general and administrative expenses):				
Oil and natural gas	**$ 8,461,000**	$ 3,500,000	**$ 18,018,000**	$ 9,514,000
Land investment, net of minority interest	**1,614,000**	314,000	**4,119,000**	3,837,000
Contract drilling	**401,000**	111,000	**1,037,000**	251,000
Residential real estate, net of minority interest	**354,000**	-	**354,000**	-
Other	**421,000**	110,000	**781,000**	320,000
Total operating profit	**11,251,000**	4,035,000	**24,309,000**	13,922,000
General and administrative expenses, net of minority interest	**(4,138,000)**	(2,251,000)	**(10,279,000)**	(8,079,000)
Bad debt expense	**(608,000)**	-	**(608,000)**	-
Interest expense	**(257,000)**	(282,000)	**(834,000)**	(738,000)
Interest income	**61,000**	162,000	**181,000**	402,000
Earnings before income taxes	**$ 6,309,000**	$ 1,664,000	**$ 12,769,000**	$ 5,507,000

Table of Contents

11. INCOME TAXES

The components of the income tax provision (benefit) for the three and nine months ended June 30, 2008 and 2007 are as follows:

	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	**2008**	2007
Current	**$ 2,730,000**	$ 776,000	**$ 5,564,000**	$ 1,646,000
Deferred	**46,000**	145,000	**(1,332,000)**	746,000