BARNWELL INDUSTRIES INC
Form 10-Q
February 13, 2008

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 December 31, 2007

or

o **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 (State or other jurisdiction of incorporation or organization)	**72-0496921** (I.R.S. Employer Identification No.)
1100 Alakea Street, Suite 2900, Honolulu, Hawaii **(Address of principal executive offices)**	**96813** **(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. (Check one):

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 February 11, 2008 there were 8,241,460 shares of common stock, par value $0.50, outstanding.

BARNWELL INDUSTRIES, INC.

AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	December 31, 2007	September 30, 2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	**$ 9,667,000**	$ 10,107,000
Accounts receivable, net	**8,143,000**	7,131,000
Deferred income taxes	**1,696,000**	2,171,000
Current taxes receivable		1,040,000
Other current assets	**1,659,000**	1,030,000
TOTAL CURRENT ASSETS	**21,165,000**	21,479,000
DEPOSITS ON RESIDENTIAL PARCELS	**800,000**	800,000
RESIDENTIAL LOTS UNDER DEVELOPMENT	**5,240,000**	5,009,000
INVESTMENT IN RESIDENTIAL PARCEL	**2,497,000**	2,383,000
INVESTMENT IN JOINT VENTURES	**2,765,000**	2,765,000
INVESTMENT IN LAND INTERESTS	**1,450,000**	1,450,000
PROPERTY AND EQUIPMENT	**207,538,000**	202,342,000
ACCUMULATED DEPRECIATION, DEPLETION, AND AMORTIZATION	**(116,084,000)**	(111,663,000)
PROPERTY AND EQUIPMENT, NET	**91,454,000**	90,679,000
TOTAL ASSETS	**$ 125,371,000**	$ 124,565,000
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	**$ 6,459,000**	$ 5,983,000
Accrued capital expenditures	**3,083,000**	2,774,000
Accrued stock appreciation rights	**1,090,000**	1,672,000
Accrued incentive plan costs	**1,612,000**	2,029,000
Other accrued compensation costs	**2,682,000**	3,228,000
Drilling advances	**1,097,000**	1,407,000
Payable to joint interest owners	**1,488,000**	1,123,000
Income taxes payable	**493,000**	
Current portion of long-term debt	**580,000**	354,000
Other current liabilities	**2,366,000**	2,160,000
TOTAL CURRENT LIABILITIES	**20,950,000**	20,730,000

LONG-TERM DEBT		**22,121,000**		22,104,000
LIABILITY FOR RETIREMENT BENEFITS		**2,465,000**		2,387,000
ASSET RETIREMENT OBLIGATION		**4,996,000**		4,734,000
DEFERRED INCOME TAXES		**17,614,000**		19,299,000
MINORITY INTEREST		**900,000**		707,000
STOCKHOLDERS EQUITY:				
Common stock, par value $0.50 per share; Authorized, 20,000,000 shares: 8,320,060 issued at December 31, 2007, 8,280,060 issued at September 30, 2007		**4,160,000**		4,140,000
Additional paid-in capital		**889,000**		738,000
Retained earnings		**47,895,000**		44,988,000
Accumulated other comprehensive income, net		**5,250,000**		4,933,000
Treasury stock, at cost: 123,600 shares at December 31, 2007, 11,900 shares at September 30, 2007		**(1,869,000)**		(195,000)
TOTAL STOCKHOLDERS EQUITY		**56,325,000**		54,604,000
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	**$**	**125,371,000**	$	124,565,000

See Notes to Condensed Consolidated Financial Statements

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BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Three months ended December 31, 2007	2006
Revenues:		
Oil and natural gas	**$ 10,090,000**	$ 8,368,000
Contract drilling	**2,210,000**	1,087,000
Sale of interest in leasehold land, net	**508,000**	1,260,000
Sale of development rights, net	**2,497,000**	2,292,000
Gas processing and other	**355,000**	261,000
	15,660,000	13,268,000
Costs and expenses:		
Oil and natural gas operating	**2,381,000**	2,440,000
Contract drilling operating	**1,821,000**	1,025,000
General and administrative	**3,075,000**	3,741,000
Depreciation, depletion and amortization	**3,743,000**	3,262,000
Interest expense	**322,000**	225,000
Minority interest in earnings	**583,000**	696,000
	11,925,000	11,389,000
Earnings before income taxes	**3,735,000**	1,879,000
Income tax provision	**416,000**	765,000
NET EARNINGS	**$ 3,319,000**	$ 1,114,000
BASIC NET EARNINGS PER COMMON SHARE	**$ 0.40**	$ 0.14
DILUTED NET EARNINGS PER COMMON SHARE	**$ 0.39**	$ 0.13
WEIGHTED-AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:		
BASIC	**8,212,712**	8,169,060
DILUTED	**8,476,595**	8,685,959

See Notes to Condensed Consolidated Financial Statements

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three months ended December 31, 2007	2006
Cash flows from operating activities:		
Net earnings	**$ 3,319,000**	$ 1,114,000
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation, depletion, and amortization	**3,743,000**	3,262,000
Minority interest in earnings	**583,000**	696,000
Retirement benefits expense	**120,000**	91,000
Accretion of asset retirement obligation	**69,000**	58,000
Asset retirement obligation payments	**(21,000)**	(55,000)
Additions to residential lots under development	**(163,000)**	
Share-based compensation	**(574,000)**	1,277,000
Deferred income taxes	**(1,519,000)**	339,000
Sale of interest in leasehold land, net	**(508,000)**	(1,260,000)
Sale of development rights, net	**(2,497,000)**	(2,292,000)
(Decrease) increase from changes in current assets and liabilities	**(811,000)**	1,986,000
Net cash provided by operating activities	**1,741,000**	5,216,000
Cash flows from investing activities:		
Proceeds from sale of development rights, net of fees paid	**2,540,000**	2,438,000
Proceeds from sale of interest in leasehold land, net of fees paid	**528,000**	1,340,000
Proceeds from gas over bitumen royalty adjustments	**51,000**	54,000
Return of capital distribution from joint venture		525,000
Purchase of lot acquisition rights		(1,400,000)
Investment in joint ventures		(3,000,000)
Capital expenditures - oil and gas	**(3,140,000)**	(4,878,000)
Capital expenditures - all other	**(123,000)**	(147,000)
Additions to investment in residential parcel	**(114,000)**	
Net cash used in investing activities	**(258,000)**	(5,068,000)
Cash flows from financing activities:		
Proceeds from long-term debt borrowings	**155,000**	
Proceeds from exercise of stock options	**1,000**	
Repayments of long-term debt	**(26,000)**	
Payment of loan commitment fee	**(100,000)**	
Distributions to minority interest partners	**(390,000)**	
Purchases of common stock for treasury	**(1,596,000)**	
Net cash used in financing activities	**(1,956,000)**	
Effect of exchange rate changes on cash and cash equivalents	**33,000**	(79,000)
Net (decrease) increase in cash and cash equivalents	**(440,000)**	69,000
Cash and cash equivalents at beginning of period	**10,107,000**	11,972,000
Cash and cash equivalents at end of period	**$ 9,667,000**	$ 12,041,000

See Notes to Condensed Consolidated Financial Statements

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BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME (LOSS)

Three months ended December 31, 2007 and 2006

(Unaudited)

	Shares Outstanding	Common Stock	Additional Paid-In Capital	Comprehensive Income (Loss)	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
Share-based compensation costs			27,000					27,000
Dividends declared, $0.10 per share					(817,000)			(817,000)
Comprehensive loss:								
Net earnings				$ 1,114,000	1,114,000			1,114,000
Other comprehensive loss foreign currency translation adjustments, net of $797,000 tax benefit				(1,321,000)		(1,321,000)		(1,321,000)
Total comprehensive loss				$ (207,000)				
At December 31, 2006	8,169,060	$ 4,085,000	$ 171,000		$ 43,821,000	$ 1,531,000	$	$ 49,608,000
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, 40,000 shares net of 5,200 shares tendered and placed in treasury	34,800	20,000	59,000				(78,000)	1,000
Share-based compensation costs			14,000					14,000
Tax benefit from employee stock option transactions			78,000					78,000
Purchases of 106,500 common shares for treasury	(106,500)						(1,596,000)	(1,596,000)
Dividends declared, $0.05 per share					(412,000)			(412,000)
Comprehensive income:								
Net earnings				$ 3,319,000	3,319,000			3,319,000
Other comprehensive income:								
Foreign currency translation adjustments, net of $175,000 of taxes				289,000		289,000		289,000

Retirement plans amortization of accumulated other comprehensive loss into net periodic benefit cost, net of $14,000 of taxes				28,000		28,000		28,000
Total comprehensive income				$ **3,636,000**				
At December 31, 2007	**8,196,460**	$ **4,160,000**	$ **889,000**		$ **47,895,000**	$ **5,250,000**	$ **(1,869,000)**	$ **56,325,000**

See Notes to Condensed Consolidated Financial Statements

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 significant 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 December 31, 2007, the Condensed Consolidated Statements of Earnings, the Condensed Consolidated Statements of Cash Flows, and the Condensed Consolidated Statements of Stockholders Equity and Comprehensive Income (Loss) for the three months ended December 31, 2007 and 2006 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 changes in cash flows at December 31, 2007 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 December 31, 2007 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.

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 months ended December 31, 2007 and 2006 are as follows:

	Three months ended December 31, 2007		
	Net Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic net earnings per share	**$ 3,319,000**	**8,212,712**	**$ 0.40**
Effect of dilutive securities - common stock options		**263,883**	
Diluted net earnings per share	**$ 3,319,000**	**8,476,595**	**$ 0.39**

	Three months ended December 31, 2006		
	Net Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic net earnings per share	$ 1,114,000	8,169,060	$ 0.14
Effect of dilutive securities - common stock options		516,899	
Diluted net earnings per share	$ 1,114,000	8,685,959	$ 0.13

3. SHARE-BASED PAYMENTS

Equity-classified Awards

A summary of the activity in Barnwell s equity-classified share options as of the beginning and end of the three months ended December 31, 2007 is presented below:

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	(40,000)	$ 1.98		
Forfeited/Expired				
Outstanding at December 31, 2007	305,000	$ 6.48	2.9	$ 1,793,000
Exercisable at December 31, 2007	252,500	$ 5.91	2.8	$ 1,629,000

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Total share-based compensation expense for equity-classified awards vested in the three months ended December 31, 2007 and 2006 was $14,000 and $27,000, respectively. There was no impact on income taxes as the expense relates to qualified options.

During the three months ended December 31, 2007, 40,000 stock options were exercised by tendering 5,200 shares of Barnwell stock at a market value of $14.95 per share plus $1,000 of cash, resulting in a $20,000 increase in common stock, a $59,000 increase in additional paid-in capital and a $78,000 increase in treasury stock. There were no other equity-classified share option grants, exercises, forfeitures or expirations of unexercised options in the three months ended December 31, 2007.

The total intrinsic value of equity options exercised during the three months ended December 31, 2007 was $523,000. There were no equity options exercised in the three months ended December 31, 2006.

Barnwell recorded a $78,000 tax benefit related to employees disqualification of qualified stock options in the three months ended December 31, 2007. The tax benefit is reflected as an increase in additional paid-in capital in the three months ended December 31, 2007. There was no disqualification of stock options in the three months ended December 31, 2006.

Liability-classified Awards

The following assumptions were used in estimating fair value for all liability-classified share options previously granted prior to October 1, 2005 and outstanding during the three months ended December 31, 2007 and 2006:

	Three months ended December 31,	
	2007	**2006**
Expected volatility range	40.3% to 68.0%	30.5% to 43.0%
Weighted-average volatility	46.0%	32.8%
Expected dividends	1.6% to 1.8%	1.1% to 1.3%
Expected term (in years)	0.4 to 4.5	1.4 to 5.5
Risk-free interest rate	3.18% to 3.45%	4.7%
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.

A summary of the activity in Barnwell s liability-classified share options as of the beginning and end of the three months ended December 31, 2007 is presented below:

Options	**Shares**	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term**	**Aggregate Intrinsic Value**
Outstanding at October 1, 2007	196,000	$ 7.54		
Granted				
Exercised				
Forfeited/Expired				
Outstanding at December 31, 2007	196,000	$ 7.54	5.6	$ 946,000
Exercisable at December 31, 2007	112,000	$ 6.59	4.6	$ 647,000

Total share-based compensation for liability-classified awards decreased $1,838,000 to a $588,000 benefit for the three months ended December 31, 2007 as compared to a $1,250,000 expense for the three months ended December 31, 2006. The related income tax effects were a $202,000 expense and a $431,000 benefit for the three months ended December 31, 2007 and 2006, respectively. Included in share-based compensation for liability-classified awards for the three months ended December 31, 2007 and 2006 was $39,000 and $189,000, respectively, of compensation expense related to shares that vested during each respective period and a $627,000 benefit and a $1,061,000 expense, respectively, due to remeasurement at December 31, 2007 and 2006 of the fair value of previously vested shares.

Summary

As of December 31, 2007, there was $166,000 of total unrecognized compensation cost related to nonvested equity-classified and liability-classified share options. That cost is expected to be recognized over 1.6 years. Total share-based compensation expense related to the vesting of awards in the three months ended December 31, 2007 and 2006 was $53,000 and $216,000, respectively. Total share-based compensation for all awards, including the impact of changes in fair values for liability-classified awards, was a $574,000 benefit and a $1,277,000 expense for the three months ended December 31, 2007 and 2006, respectively. The income tax effect on total compensation of all awards was a $202,000 expense and a $431,000 benefit for the three months ended December 31, 2007 and 2006, respectively.

4. <u>CASH AND CASH EQUIVALENTS</u>

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 PARCEL

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 December 31, 2007, Kaupulehu 2007 has made nonrefundable initial deposits on four parcels totaling $800,000 to secure the right to purchase the parcels at a price of $2,378,000 each in the Lot 4A Increment I area from WB KD Acquisition, LLC (WB), an unrelated entity. In January 2008, Barnwell acquired one residential parcel and paid $2,178,000 representing the balance of the purchase price of the parcel (see further discussion in Note 17 below). The purchase of each of the remaining three lots is scheduled to close in March 2008, June 2008 and September 2008. The deposits are classified as Deposits on Residential Parcels on the Condensed Consolidated Balance Sheets at December 31, 2007 and September 30, 2007. If any of the parcels are not purchased, the deposit related to any such parcels will be forfeited and Barnwell will incur an expense as a result of the write-off of its 80% share of any forfeited deposits.

As of December 31, 2007, Kaupulehu 2007 has purchased three parcels in the Lot 4A Increment I area. Barnwell is in the process of developing residences for future sale on two of the parcels and intends to hold the third parcel for investment purposes. The two parcels held for development are classified as Residential Lots Under Development and the third parcel is classified as Investment in Residential Parcel on the Condensed Consolidated Balance Sheets at December 31, 2007 and September 30, 2007.

As of the date of this filing, the planning process is complete for the two residences being developed for resale, site work has been substantially completed to expand the building envelope on the two lots and construction commenced on the two homes.

Kaupulehu 2007 entered into an agreement with Mr. David Johnston, the son of Mr. Terry Johnston, a director of Barnwell, under which Mr. David Johnston will serve as Kaupulehu 2007 s project manager. Kaupulehu 2007 also entered into an agreement with an independent building contractor for home building services for Kaupulehu 2007 s lots. A significant provision of these agreements is that Mr. David Johnston and the building contractor will each receive 20% of the profit on the sale of each lot on which a house is constructed and have the right to purchase from WB one of the remaining lots Kaupulehu 2007 has agreed to acquire. It is anticipated that any such service provider acquiring a lot will reimburse Kaupulehu 2007 for both the $200,000 deposit on such lot and interest costs incurred by Kaupulehu 2007 related to the initial deposit on such lot.

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 (hereinafter referred to as Hualalai Investors), owners of Hualalai Resort, and Kona Village Investors, LLC (Kona Village Investors), owners of Kona Village Resort. The investments in Hualalai Investors and Kona Village Investors are reflected in the Condensed Consolidated Balance Sheets as of December 31, 2007 and September 30, 2007 as Investment in Joint Ventures.

7. INVESTMENT IN LAND INTERESTS

The land interests held by Barnwell at December 31, 2007 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 successfully negotiate development terms and agreements within 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 December 31, 2007 and September 30, 2007 Condensed Consolidated Balance Sheets under the caption Investment in Land Interests and consists of the following amounts:

		December 31, 2007		**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 and percentage of sales payment proceeds received during the three months ended December 31, 2007 were reduced by $159,000 and $32,000, respectively, of fees; 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 three months ended December 31, 2007 with the balance paid to Nearco in January 2008. 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 entered into an agreement with Mr. David Johnston, the son of Mr. Terry Johnston, a director of Barnwell, under which Mr. David Johnston will serve as Kaupulehu 2007 s project manager. Kaupulehu 2007 also entered into an agreement with an independent building contractor for home building services for Kaupulehu 2007 s lots. A significant provision of these agreements is that Mr. David Johnston and the building contractor will each receive 20% of the profit on the sale of each lot on which a house is constructed and have the right to purchase from WB one of the remaining lots Kaupulehu 2007 has agreed to acquire. It is anticipated that any such service provider acquiring a lot will reimburse Kaupulehu 2007 for both the $200,000 deposit on such lot and interest costs incurred by Kaupulehu 2007 related to the initial deposit on such lot. Kaupulehu 2007 has borrowings under a credit facility that is guaranteed jointly and severally by Barnwell and Mr. Johnston, with Mr. 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 December 31, 2007, interest accrued on the Nearco loan totaled $10,000. The loan balance is to be reduced in the future by any contributions to Kaupulehu 2007 by Barnwell that are not matched by Nearco in proportion to its ownership interest in Kaupulehu 2007.

General and administrative expenses include fees paid to Nearco for consulting services related to Kaupulehu Developments leasehold land. Fees paid to Nearco totaled $33,000 and $42,000, before minority interest, in the three months ended December 31, 2007 and 2006, respectively.

9. LONG-TERM DEBT

A summary of Barnwell s long-term debt (including the current portion) as of December 31, 2007 and September 30, 2007 is as follows:

	December 31, 2007	September 30, 2007
Canadian revolving credit facility	**$ 14,566,000**	$ 14,520,000
Real estate revolving credit facility	**6,600,000**	
Real estate non-revolving credit facility	**468,000**	6,845,000
Related party loan	**525,000**	525,000
Drill rig financing	**542,000**	568,000
Total long-term debt	**$ 22,701,000**	$ 22,458,000

Barnwell has a credit facility at Royal Bank of Canada, a Canadian bank, for $20,000,000 Canadian dollars, or approximately US$20,240,000 at December 31, 2007 exchange rates. Borrowings under this facility were US$14,566,000 at December 31, 2007 and are included in long-term debt. At December 31, 2007, Barnwell had unused credit available under this facility of approximately US$5,674,000.

The bank affirmed that it will not require any repayments under the facility before January 1, 2009. Accordingly, Barnwell has classified outstanding borrowings under the facility as long-term debt.

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 these borrowings 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 (see further discussion in Note 17 below), 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 valid first mortgage lien on the parcels and homes to be built. Kaupulehu 2007 incurred a 1% 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.

At December 31, 2007, Kaupulehu 2007 s borrowings under the revolving credit facility were $6,600,000. The facility expires in December 2010. Accordingly, the $6,600,000 is classified as long-term debt on the Condensed Consolidated Balance Sheet at December 31, 2007. However, as discussed above, a portion of the cash proceeds from the sales of completed homes may be required to be applied to the facility balance if such sales occur prior to December 2010. Based upon the builder s estimated project timeline, Barnwell does not expect sales of homes to occur on or before December 31, 2008. At December 31, 2007, Barnwell had unused credit available under this facility of approximately $9,400,000. The $468,000 portion of the outstanding loan balance under the non-revolving facility that was not refinanced is due October 1, 2008 and accordingly, is classified as a current liability on the Condensed Consolidated Balance Sheet at December 31, 2007.

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 $81,000 for the three months ended December 31, 2007.

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. Based upon the builder s estimated project timeline, Barnwell does not expect sales of homes to occur on or before December 31, 2008; accordingly, the $525,000 is classified as long-term debt on the Condensed Consolidated Balance Sheet at December 31, 2007. The loan balance is to be reduced in the future by any contributions to Kaupulehu 2007 by Barnwell that are not matched by Nearco in proportion to its ownership interest in Kaupulehu 2007.

Interest costs for the three months ended December 31, 2007 and 2006 are summarized as follows:

	Three months ended December 31,			
		2007		**2006**
Interest costs incurred	**$**	**403,000**	$	225,000
Less interest costs capitalized on residential lots under development		**81,000**		
Interest expense	**$**	**322,000**	$	225,000

10. **<u>SEGMENT INFORMATION</u>**

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) acquisition of property for investment and development of homes for sale in Hawaii (real estate development, established January 2007); and 4) drilling wells and installing and repairing water pumping systems in Hawaii (contract drilling). There were no real estate development segment operating revenues or operating expenses during the three months ended December 31, 2007 and 2006.

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

	Three months ended December 31, 2007	2006
Revenues:		
Oil and natural gas	**$ 10,090,000**	$ 8,368,000
Land investment	**3,005,000**	3,552,000
Contract drilling	**2,210,000**	1,087,000
Other	**279,000**	161,000
Total before interest income	**15,584,000**	13,168,000
Interest income	**76,000**	100,000
Total revenues	**$ 15,660,000**	$ 13,268,000
Depreciation, depletion and amortization:		
Oil and natural gas	**$ 3,614,000**	$ 3,160,000
Contract drilling	**81,000**	52,000
Other	**48,000**	50,000
Total depreciation, depletion and amortization	**$ 3,743,000**	$ 3,262,000
Operating profit (before general and administrative expenses):		
Oil and natural gas	**$ 4,095,000**	$ 2,768,000
Land investment, net of minority interest	**2,348,000**	2,775,000
Contract drilling	**308,000**	10,000
Other	**231,000**	111,000
Total operating profit	**6,982,000**	5,664,000
General and administrative expenses, net of minority interest	**(3,001,000)**	(3,660,000)
Interest expense	**(322,000)**	(225,000)
Interest income	**76,000**	100,000
Earnings before income taxes	**$ 3,735,000**	$ 1,879,000

11. INCOME TAXES

The components of the income tax provision for the three months ended December 31, 2007 and 2006 are as follows:

	Three months ended December 31, 2007	2006
Current	**$ 1,935,000**	$ 426,000
Deferred	**(1,519,000)**	339,000
	$ 416,000	$ 765,000

During the three months ended December 31, 2007, the Canadian government enacted reductions in the corporate tax rate from 20.5%, 20.0%, 19.0%, 18.5% and 18.5% in calendar years 2008, 2009, 2010, 2011 and 2012, respectively, to 19.5%, 19.0%, 18.0%, 16.5% and 15%, respectively. This reduction in Canadian federal tax rates resulted in a $909,000 reduction of the net deferred tax liability during the three months ended December 31, 2007. There was no such reduction in the same period of the prior year.

Due to differences in the statutory deduction rates for Barnwell s Canadian oil and natural gas capital expenditures under Canadian law as compared to such deductions under U.S. tax law, Barnwell has incurred higher U.S. tax liabilities on Canadian source earnings than Canadian tax liabilities on such earnings in recent years. As a result, Barnwell has utilized its foreign tax credit carryforwards in recent years, and Barnwell estimates that it will fully utilize its remaining foreign tax credit carryforward balance in fiscal 2008.

Barnwell s effective consolidated income tax rate for the three months ended December 31, 2007, excluding the aforementioned $909,000 impact of the reduction in Canadian income tax rates, was approximately 35%.

In June 2006, the Financial Accounting Standards Board (the FASB) issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. This interpretation prescribes a threshold for recognizing the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination by a taxing authority. Recognized tax positions are initially and subsequently measured as the largest amount of tax benefit that is more likely than not of being realized upon ultimate settlement with a taxing authority. Liabilities for unrecognized tax benefits related to such tax positions are included in other long-term liabilities unless the tax position is expected to be settled within the upcoming year, in which case the liabilities are included in accrued expenses and other current liabilities. Interest and penalties related to unrecognized tax benefits are included in income tax expense. Effective October 1, 2007, Barnwell adopted the provisions of FIN No. 48. The adoption of FIN No. 48 did not have a material impact on Barnwell s financial statements.

Included below is a summary of the tax years, by jurisdiction, that remain subject to examination by taxing authorities:

Jurisdiction	**Fiscal Years Open**
U.S. federal	2004 2006
Various U.S. states	2004 2006
Canada federal	2000 2006
Various Canadian provinces	2004 2006

12. **RETIREMENT PLANS**

Barnwell sponsors a noncontributory defined benefit pension plan (pension plan) covering substantially all of its U.S. employees. Additionally, Barnwell sponsors a Supplemental Employee Retirement Plan (SERP), a noncontributory supplemental retirement benefit plan which covers certain current and former employees of Barnwell for amounts exceeding the limits allowed under the defined benefit pension plan and a postretirement medical insurance benefits plan (postretirement medical) covering eligible U.S. employees.

The following table details the components of net periodic benefit cost for Barnwell s retirement plans for the three months ended December 31, 2007 and 2006:

	Pension		**SERP** **Three months ended December 31,**		**Postretirement Medical**	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
Service cost	**$ 50,000**	$ 52,000	**$ 8,000**	$ 7,000	**$ 2,000**	$ 1,000
Interest cost	**70,000**	62,000	**11,000**	9,000	**13,000**	4,000
Expected return on plan assets	**(76,000)**	(67,000)				
Amortization of prior service cost	**1,000**	1,000	**1,000**	1,000	**34,000**	12,000
Amortization of net actuarial loss (gain)	**5,000**	9,000	**2,000**		**(1,000)**	
Net periodic benefit cost	**$ 50,000**	$ 57,000	**$ 22,000**	$ 17,000	**$ 48,000**	$ 17,000

Barnwell did not make a contribution to the pension plan during the three months ended December 31, 2007. The SERP and postretirement medical plans are unfunded and Barnwell will fund benefits when payments are made. Barnwell estimates that it will make approximately $350,000 in contributions to the pension plan during the remainder of fiscal 2008.

In 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Act) was signed into law. The Act introduced a prescription drug benefit under Medicare as well as a potential federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D to help offset the costs of participant prescription drug benefits. Any measures of the accumulated postretirement benefit obligation at December 31, 2007

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and September 30, 2007 or net periodic postretirement benefit cost in the condensed consolidated financial statements or accompanying notes for the three months ended December 31, 2007 and 2006 do not reflect the effects of the Act on the postretirement medical insurance benefits plan.

13. SHARE REPURCHASE PROGRAM

In December 2005, Barnwell s Board of Directors authorized the purchase of up to 250,000 shares of its common stock in the open market or in privately negotiated transactions. On September 20, 2007, the Board of Directors authorized a stock repurchase program in the open market of up to 150,000 shares of these 250,000 shares during the period commencing on September 24, 2007 and ending on March 24, 2008. During the year ended September 30, 2007, Barnwell repurchased 10,000 shares for an aggregate purchase price of $155,000, or approximately $15.50 per share, pursuant to the plan. During the quarter ended December 31, 2007, Barnwell repurchased 106,500 shares of its common stock for $1,596,000, or approximately $14.99 per share. Of these amounts, 71,500 shares were purchased for $1,062,000, or approximately $14.86 per share, on the open market under the September 20, 2007 authorization, and 35,000 shares were purchased for $15.25 per share, the closing market price on the date of the transaction, or approximately $534,000, in a privately negotiated transaction with an officer/director of Barnwell. As of December 31, 2007, there were 133,500 shares available for repurchase under the December 2005 authorization.

14. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash and cash equivalents, accounts receivable, and accounts payable approximate fair value because of the short maturity of these instruments. The carrying value of long-term debt approximates fair value as the terms approximate current market terms for similar debt instruments of comparable risk and maturities.

The differences between the estimated fair values and carrying values of Barnwell s financial instruments are not material.

15. RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, however, for some entities, the application of SFAS No. 157 will change current practice. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. Barnwell s management is currently evaluating the effect of these provisions on Barnwell s results of operations, financial condition and liquidity.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115. SFAS No. 159 provides companies with an option to report selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are

reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected are recognized in earnings as incurred. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Barnwell s management is currently evaluating the effect of these provisions on Barnwell s results of operations, financial condition and liquidity.

In June 2007, the FASB ratified the Emerging Issues Task Force (EITF) consensus on EITF Issue No. 06-11, Accounting for Income Tax Benefits on Dividends on Share-Based Payment Awards. This EITF Issue indicates that tax benefits of dividends on unvested restricted stock are to be recognized in equity as an increase in the pool of excess tax benefits. Should the related awards forfeit or no longer become expected to vest, the benefits are to be reclassified from equity to the income statement. EITF Issue No. 06-11 is effective for fiscal years beginning after December 15, 2007. Barnwell will adopt EITF Issue No. 06-11 as required and management does not expect it to have any impact on Barnwell s results of operations, financial condition or liquidity.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations. SFAS No. 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any controlling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) applies to business combinations for which the acquisition date is on or after December 15, 2008. Barnwell s management is currently evaluating the impact of these provisions on Barnwell s results of operations, financial condition and liquidity.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment to Accounting Research Bulletin No. 51. SFAS No. 160 establishes accounting and reporting standards that require the ownership interest in subsidiaries held by parties other than the parent be clearly identified and presented in the Consolidated Balance Sheets within equity, but separate from the parent s equity; the amount of consolidated net income attributable to the parent and the noncontrolling interest be clearly identified and presented on the face of the Consolidated Statement of Earnings; and changes in a parent s ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. This statement is effective for fiscal years beginning on or after December 15, 2008. Barnwell s management is currently evaluating the impact of these provisions on Barnwell s results of operations, financial condition and liquidity.

16. SUPPLEMENTAL STATEMENTS OF CASH FLOWS INFORMATION

	Three months ended December 31, 2007	2006
Supplemental disclosures of cash flow information:		