

BARNWELL INDUSTRIES INC  
Form 10QSB  
May 15, 2003

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-QSB**

(Mark One)

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

For the quarterly period ended March 31, 2003

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 1-5103

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**BARNWELL INDUSTRIES, INC.**

(Exact name of small business issuer 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**

(Issuer's telephone number, including area code)

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

As of May 13, 2003 there were 1,314,510 shares of common stock, par value \$0.50, outstanding.

Transitional Small Business Disclosure Format. Yes  No

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**BARNWELL INDUSTRIES, INC.  
AND SUBSIDIARIES**

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**PART 1. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited, see Note A below)**

|               | <u>March 31,<br/>2003</u> | <u>September 30,<br/>2002</u> |
|---------------|---------------------------|-------------------------------|
| <b>ASSETS</b> |                           |                               |

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|   | March 31,<br>2003           | September 30,<br>2002       |
|---|-----------------------------|-----------------------------|
|   | <u>                    </u> | <u>                    </u> |
| <b>CURRENT ASSETS:</b>  |                             |                             |
| Cash and cash equivalents   | \$ 1,886,000                | \$ 1,489,000                |
| Accounts receivable, net  | 3,916,000                   | 3,031,000                   |
| Note receivable   | 1,311,000                   | 1,381,000                   |
| Other current assets  | 1,036,000                   | 1,205,000                   |
|   | <u>                    </u> | <u>                    </u> |
| <b>TOTAL CURRENT ASSETS</b>   | <b>8,149,000</b>            | 7,106,000                   |
| <b>INVESTMENT IN LAND</b>   | <b>6,508,000</b>            | 7,740,000                   |
| <b>NET PROPERTY AND EQUIPMENT</b>   | <b>32,522,000</b>           | 25,828,000                  |
|   | <u>                    </u> | <u>                    </u> |
| <b>TOTAL ASSETS</b>   | <b>\$ 47,179,000</b>        | \$ 40,674,000               |
|   | <u>                    </u> | <u>                    </u> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                     |                             |                             |
| <b>CURRENT LIABILITIES:</b>   |                             |                             |
| Accounts payable  | \$ 3,174,000                | \$ 2,995,000                |
| Accrued liabilities   | 4,764,000                   | 3,367,000                   |
| Income taxes payable  | 1,188,000                   |                             |
| Other current liabilities   | 929,000                     | 841,000                     |
| Current portion of long-term debt   | 180,000                     | 360,000                     |
|   | <u>                    </u> | <u>                    </u> |
| <b>TOTAL CURRENT LIABILITIES</b>  | <b>10,235,000</b>           | 7,563,000                   |
|   | <u>                    </u> | <u>                    </u> |
| <b>LONG-TERM DEBT</b>   | <b>9,725,000</b>            | 9,961,000                   |
|   | <u>                    </u> | <u>                    </u> |
| <b>ASSET RETIREMENT OBLIGATION</b>  | <b>1,314,000</b>            |                             |
|   | <u>                    </u> | <u>                    </u> |
| <b>DEFERRED INCOME TAXES</b>  | <b>7,890,000</b>            | 7,429,000                   |
|   | <u>                    </u> | <u>                    </u> |
| <b>MINORITY INTEREST</b>  | <b>880,000</b>              | 800,000                     |
|   | <u>                    </u> | <u>                    </u> |
| <b>STOCKHOLDERS' EQUITY:</b>  |                             |                             |
| Common stock, par value \$0.50 per share:                                       |                             |                             |
| Authorized, 4,000,000 shares  |                             |                             |
| Issued, 1,642,797 shares  | 821,000                     | 821,000                     |
| Additional paid-in capital  | 3,139,000                   | 3,139,000                   |
| Retained earnings   | 20,868,000                  | 19,698,000                  |
| Accumulated other comprehensive loss - foreign currency translation adjustments | (2,839,000)                 | (3,883,000)                 |
| Treasury stock, at cost, 328,287 shares   | (4,854,000)                 | (4,854,000)                 |
|   | <u>                    </u> | <u>                    </u> |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | <b>17,135,000</b>           | 14,921,000                  |
|   | <u>                    </u> | <u>                    </u> |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                               | <b>\$ 47,179,000</b>        | \$ 40,674,000               |
|   | <u>                    </u> | <u>                    </u> |

Note A: The condensed consolidated balance sheet at September 30, 2002 has been derived from the audited consolidated financial statements at that date.

See Notes to Condensed Consolidated Financial Statements

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**BARNWELL INDUSTRIES, INC.  
AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)**

|   | Three months ended<br>March 31, |                     | Six months ended<br>March 31, |                    |
|---|---------------------------------|---------------------|-------------------------------|--------------------|
|   | 2003                            | 2002                | 2003                          | 2002               |
| <b>Revenues:</b>                                |                                 |                     |                               |                    |
| Oil and natural gas                             | \$ 5,140,000                    | \$ 2,530,000        | \$ 8,960,000                  | \$ 5,100,000       |
| Contract drilling                               | 550,000                         | 940,000             | 1,560,000                     | 2,120,000          |
| Sale of development rights, net                 |                                 |                     | 720,000                       | 120,000            |
| Gas processing and other                        | 300,000                         | 240,000             | 730,000                       | 380,000            |
|   | <u>5,990,000</u>                | <u>3,710,000</u>    | <u>11,970,000</u>             | <u>7,720,000</u>   |
| <b>Costs and expenses:</b>                      |                                 |                     |                               |                    |
| Oil and natural gas operating                   | 920,000                         | 856,000             | 1,997,000                     | 1,736,000          |
| Contract drilling operating                     | 581,000                         | 624,000             | 1,367,000                     | 1,458,000          |
| General and administrative                      | 1,614,000                       | 1,042,000           | 3,048,000                     | 2,025,000          |
| Depreciation, depletion and amortization        | 919,000                         | 841,000             | 1,804,000                     | 1,809,000          |
| Interest expense                                | 122,000                         | 77,000              | 202,000                       | 137,000            |
| Minority interest in earnings (losses)          | (42,000)                        | (1,000)             | 355,000                       | 119,000            |
|   | <u>4,114,000</u>                | <u>3,439,000</u>    | <u>8,773,000</u>              | <u>7,284,000</u>   |
| Earnings before income taxes                    | 1,876,000                       | 271,000             | 3,197,000                     | 436,000            |
| Income tax provision                            | 1,576,000                       | 481,000             | 2,027,000                     | 496,000            |
| <b>NET EARNINGS (LOSS)</b>                      | <u>\$ 300,000</u>               | <u>\$ (210,000)</u> | <u>\$ 1,170,000</u>           | <u>\$ (60,000)</u> |
| <b>BASIC EARNINGS (LOSS) PER COMMON SHARE</b>   | <u>\$ 0.23</u>                  | <u>\$ (0.16)</u>    | <u>\$ 0.89</u>                | <u>\$ (0.05)</u>   |
| <b>DILUTED EARNINGS (LOSS) PER COMMON SHARE</b> | <u>\$ 0.22</u>                  | <u>\$ (0.16)</u>    | <u>\$ 0.86</u>                | <u>\$ (0.05)</u>   |

See Notes to Condensed Consolidated Financial Statements

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**BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)**

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|  | Six months ended<br>March 31, |                    |
|--|-------------------------------|--------------------|
|  | 2003                          | 2002               |
| <b>Cash flows from operating activities:</b>   |                               |                    |
| Net earnings (loss)  | \$ 1,170,000                  | \$ (60,000)        |
| Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities: |                               |                    |
| Depreciation, depletion, and amortization  | 1,804,000                     | 1,809,000          |
| Minority interest in earnings  | 355,000                       | 119,000            |
| Accretion of asset retirement obligation   | 40,000                        |                    |
| Deferred income taxes  | (111,000)                     | (129,000)          |
| Sale of development rights, net  | (720,000)                     | (120,000)          |
|  | <b>2,538,000</b>              | <b>1,619,000</b>   |
| Increase (decrease) from changes in current assets and liabilities                                   | 950,000                       | (3,225,000)        |
| Net cash provided by (used in) operating activities  | <b>3,488,000</b>              | <b>(1,606,000)</b> |
| <b>Cash flows from investing activities:</b>   |                               |                    |
| Proceeds from sale of development rights, net  | 1,997,000                     | 1,997,000          |
| Proceeds from collection of note receivable  | 70,000                        | 100,000            |
| Decrease in other assets   |                               | 6,000              |
| Capital expenditures oil and natural gas   | (4,111,000)                   | (2,582,000)        |
| Capital expenditures other   | (80,000)                      | (123,000)          |
| Additions to investment in land  | (45,000)                      | (554,000)          |
| Net cash used in investing activities  | <b>(2,169,000)</b>            | <b>(1,156,000)</b> |
| <b>Cash flows from financing activities:</b>   |                               |                    |
| Distribution to minority interest partners   | (275,000)                     | (278,000)          |
| Repayments of long-term debt   | (630,000)                     | (190,000)          |
| Long-term debt borrowings  |                               | 2,678,000          |
| Payment of dividends   |                               | (394,000)          |
| Repayment of notes payable   |                               | (2,209,000)        |
| Net cash used in financing activities  | <b>(905,000)</b>              | <b>(393,000)</b>   |
| Effect of exchange rate changes on cash and cash equivalents   | (17,000)                      | (33,000)           |
| Net increase (decrease) in cash and cash equivalents   | 397,000                       | (3,188,000)        |
| Cash and cash equivalents at beginning of period   | 1,489,000                     | 5,154,000          |
| Cash and cash equivalents at end of period   | \$ 1,886,000                  | \$ 1,966,000       |
| <b>Supplemental disclosures of cash flow information:</b>  |                               |                    |
| Cash paid during the period for:   |                               |                    |
| Interest (net of amounts capitalized)  | \$ 207,000                    | \$ 115,000         |
| Income taxes   | \$ 830,000                    | \$ 2,901,000       |

Six months ended  
March 31,

Supplemental disclosure of non-cash investing and financing activities:

For the six months ended March 31, 2003, net oil and natural gas properties increased \$1,271,000 and the asset retirement obligation increased \$1,314,000, including accretion of the asset retirement obligation of \$40,000, as a result of adoption of Statement of Financial Accounting Standards No. 143 on October 1, 2002.

In December 2001, approximately \$71,000 of convertible debentures, including accrued interest, was converted to 3,558 shares of Barnwell's stock at \$20 per share; these shares were issued from Barnwell's treasury stock.

See Notes to Condensed Consolidated Financial Statements

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**BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)**  
**Three months ended March 31, 2003 and 2002**  
**(Unaudited)**

|  | Common<br>Stock | Additional<br>Paid-In<br>Capital | Comprehensive<br>Income<br>(Loss) | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury<br>Stock | Total<br>Stockholders'<br>Equity |
|--|-----------------|----------------------------------|-----------------------------------|----------------------|---|-------------------|----------------------------------|
| Balances at December 31, 2001  | \$ 821,000      | \$ 3,139,000                     |                                   | \$ 19,808,000        | \$ (3,914,000)                                | \$ (4,854,000)    | \$ 15,000,000                    |
| Comprehensive loss:  |                 |                                  |                                   |                      |   |                   |                                  |
| Net loss   |                 |                                  | \$ (210,000)                      | (210,000)            |   |                   | (210,000)                        |
| Other comprehensive loss, net of<br>income taxes foreign currency<br>translation adjustments   |                 |                                  | (16,000)                          |                      | (16,000)                                      |                   | (16,000)                         |
| Total comprehensive loss   |                 |                                  | \$ (226,000)                      |                      |   |                   |                                  |
| Balances at March 31, 2002   | \$ 821,000      | \$ 3,139,000                     |                                   | \$ 19,598,000        | \$ (3,930,000)                                | \$ (4,854,000)    | \$ 14,774,000                    |
| Balances at December 31, 2002  | \$ 821,000      | \$ 3,139,000                     |                                   | \$ 20,568,000        | \$ (3,843,000)                                | \$ (4,854,000)    | \$ 15,831,000                    |
| Comprehensive income:  |                 |                                  |                                   |                      |   |                   |                                  |
| Net earnings   |                 |                                  | \$ 300,000                        | 300,000              |   |                   | 300,000                          |
| Other comprehensive income, net of<br>income taxes foreign currency<br>translation adjustments |                 |                                  | 1,004,000                         |                      | 1,004,000                                     |                   | 1,004,000                        |
| Total comprehensive income   |                 |                                  | \$ 1,304,000                      |                      |   |                   |                                  |
| Balances at March 31, 2003   | \$ 821,000      | \$ 3,139,000                     |                                   | \$ 20,868,000        | \$ (2,839,000)                                | \$ (4,854,000)    | \$ 17,135,000                    |

See Notes to Condensed Consolidated Financial Statements

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**BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)**  
**Six months ended March 31, 2003 and 2002**  
**(Unaudited)**

|  | Common<br>Stock   | Additional<br>Paid-In<br>Capital | Comprehensive<br>Income<br>(Loss) | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury<br>Stock     | Total<br>Stockholders'<br>Equity |
|--|-------------------|----------------------------------|-----------------------------------|----------------------|---|-----------------------|----------------------------------|
| Balances at September 30, 2001   | \$ 821,000        | \$ 3,105,000                     |                                   | \$ 19,855,000        | \$ (3,797,000)                                | \$ (4,891,000)        | \$ 15,093,000                    |
| Conversion of debentures to common stock at \$20.00 per share                            |                   | 34,000                           |                                   |                      |   | 37,000                | 71,000                           |
| Dividends declared (\$0.15 per share)  |                   |                                  |                                   | (197,000)            |   |                       | (197,000)                        |
| Comprehensive loss:  |                   |                                  |                                   |                      |   |                       |                                  |
| Net loss   |                   |                                  | \$ (60,000)                       | (60,000)             |   |                       | (60,000)                         |
| Other comprehensive loss, net of income taxes foreign currency translation adjustments   |                   |                                  | (133,000)                         |                      | (133,000)                                     |                       | (133,000)                        |
| <b>Total comprehensive loss</b>  |                   |                                  | <b>\$ (193,000)</b>               |                      |   |                       |                                  |
| Balances at March 31, 2002   | \$ 821,000        | \$ 3,139,000                     |                                   | \$ 19,598,000        | \$ (3,930,000)                                | \$ (4,854,000)        | \$ 14,774,000                    |
| Balances at September 30, 2002   | \$ 821,000        | \$ 3,139,000                     |                                   | \$ 19,698,000        | \$ (3,883,000)                                | \$ (4,854,000)        | \$ 14,921,000                    |
| Comprehensive income:  |                   |                                  |                                   |                      |   |                       |                                  |
| Net earnings   |                   |                                  | \$ 1,170,000                      | 1,170,000            |   |                       | 1,170,000                        |
| Other comprehensive income, net of income taxes foreign currency translation adjustments |                   |                                  | 1,044,000                         |                      | 1,044,000                                     |                       | 1,044,000                        |
| <b>Total comprehensive income</b>  |                   |                                  | <b>\$ 2,214,000</b>               |                      |   |                       |                                  |
| <b>Balances at March 31, 2003</b>  | <b>\$ 821,000</b> | <b>\$ 3,139,000</b>              |                                   | <b>\$ 20,868,000</b> | <b>\$ (2,839,000)</b>                         | <b>\$ (4,854,000)</b> | <b>\$ 17,135,000</b>             |

See Notes to Condensed Consolidated Financial Statements

**BARNWELL INDUSTRIES, INC.**  
**AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The Condensed Consolidated Balance Sheet as of March 31, 2003, the Consolidated Statements of Operations for the three and six months ended March 31, 2003 and 2002, the Condensed Consolidated Statements of Cash Flows for the six months ended March 31, 2003 and 2002, and the Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the three and six months ended March 31, 2003 and 2002 have been prepared by Barnwell Industries, Inc. (referred to herein together with its subsidiaries as "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 March 31, 2003 and for all periods presented have been made. The Condensed Consolidated Balance Sheet as of September 30, 2002 has been derived from audited financial statements.

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Certain information and footnote disclosures normally included in 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 financial statements and notes thereto included in Barnwell's September 30, 2002 annual report on Form 10-KSB. The results of operations for the period ended March 31, 2003 are not necessarily indicative of the operating results for the full year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management 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.

### 2. EARNINGS PER COMMON SHARE

Basic earnings per share ("EPS") excludes dilution and is computed by dividing net earnings by the weighted-average number of common shares outstanding for the period. The weighted-average number of common shares outstanding was 1,314,510 for both the three and six months ended March 31, 2003, and 1,314,510 and 1,313,317 for the three and six months ended March 31, 2002, respectively.

Diluted EPS includes the potentially dilutive effect of outstanding common stock options and securities which are convertible to common shares. The weighted-average number of common and potentially dilutive common shares outstanding were 1,366,528 and 1,362,869 for the three and six months ended March 31, 2003, respectively, and 1,314,510 and 1,313,317 for the three and six months ended March 31, 2002, respectively.

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Reconciliations between the numerator and denominator of the basic and diluted earnings per share computations for the three and six months ended March 31, 2003 are as follows (there were no reconciling items for the three and six months ended March 31, 2002):

| Three months ended March 31, 2003                  |                             |                         |                     |
|--|-----------------------------|-------------------------|---------------------|
|  | Net Earnings<br>(Numerator) | Shares<br>(Denominator) | Per-Share<br>Amount |
| Basic earnings per share                           | \$ 300,000                  | 1,314,510               | \$ 0.23             |
| Effect of dilutive securities common stock options |                             | 52,018                  |                     |
| Diluted earnings per share                         | \$ 300,000                  | 1,366,528               | \$ 0.22             |
| Six months ended March 31, 2003                    |                             |                         |                     |
|  | Net Earnings<br>(Numerator) | Shares<br>(Denominator) | Per-Share<br>Amount |
| Basic earnings per share                           | \$ 1,170,000                | 1,314,510               | \$ 0.89             |
| Effect of dilutive securities common stock options |                             | 48,359                  |                     |
| Diluted earnings per share                         | \$ 1,170,000                | 1,362,869               | \$ 0.86             |

Assumed conversion of convertible debentures to 9,000 shares of common stock were excluded from the computation of diluted EPS for the three and six months ended March 31, 2003 because their effect would be antidilutive.



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Assumed conversion of common stock options and convertible debentures to 146,000 and 27,000 shares of common stock, respectively, at March 31, 2002 were excluded from the computation of diluted EPS for the three and six months ended March 31, 2002 because their effect would be antidilutive.

### 3. INVESTMENT IN LAND

Barnwell owns a 77.6% controlling interest in Kaupulehu Developments, a Hawaii general partnership that owns interests in leasehold land and development rights for property located approximately six miles north of the Kona International Airport in the North Kona District of the Island of Hawaii.

The leasehold land interests held by Kaupulehu Developments are for approximately 870 acres of land zoned for resort/residential development and approximately 1,000 acres of land zoned conservation district. These approximately 1,870 acres are located adjacent to and north of the Four Seasons Resort Hualalai at Historic Ka'upulehu, between the Queen Kaahumanu Highway and the Pacific Ocean. Kaupulehu Developments is negotiating with an independent party interested in developing the approximately 870 acres of resort/residential leasehold acreage (of which approximately 186 acres were designated by the State Land Use Commission as preservation areas with no residential or golf course development) and continues to negotiate a revised development agreement and residential fee simple purchase prices with the lessor. Management cannot predict the outcome of these negotiations.

The development rights held by Kaupulehu Developments are for residentially zoned leasehold land within and adjacent to the Hualalai Golf Club and are under option to Kaupulehu Makai Venture, an unrelated entity that is an affiliate of Kajima Corporation of Japan. On December 31, 2002, Kaupulehu Makai Venture exercised the portion of its development rights option due on that date and paid Kaupulehu Developments \$2,125,000, reducing the amount of acreage under option to approximately 110 acres. Barnwell accounts for sales of development rights under option by use of the cost recovery method. Under the cost recovery method, no operating profit is recognized until cash received exceeds the cost and the estimated future costs related to development rights sold. Accordingly, in consolidation, \$1,277,000 of the proceeds from the sales of development rights were applied to reduce the carrying value of the underlying development rights recorded on the Condensed Consolidated Balance Sheets under the caption "Investment in land" to zero. Additionally, sales of development rights were further reduced by \$128,000 of fees related to the sale. The remaining \$720,000 of sales proceeds is recorded in the Consolidated Statements of Operations for the six months

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ended March 31, 2003 as "Sale of development rights, net." There were no sales of development rights in the three months ended March 31, 2003. The total amount of the remaining option proceeds, if fully exercised, was \$21,250,000 at March 31, 2003, eight payments of \$2,656,250 due on each December 31 of years 2003 to 2010. If any annual option payment is not made, the then remaining development right options will expire. There is no assurance that any portion of the remaining options will be exercised.

The aforementioned \$128,000 in fees (\$89,000, net of minority interest) on the \$2,125,000 development rights proceeds were paid in January 2003 to Nearco, Inc., a company controlled by Mr. Terry Johnston, a director of Barnwell and an indirect 21.8% owner of Kaupulehu Developments. Under an agreement entered into in 1987, prior to Mr. Johnston's election to Barnwell's Board of Directors, Barnwell is obligated to pay Nearco, Inc. 2% of Kaupulehu Developments' gross receipts from the sale of real estate interests. In addition, Cambridge Hawaii Limited Partnership, a 49.9% partner of Kaupulehu Developments, in which Barnwell purchased a 55.2% interest in April 2001, is obligated under an agreement entered into in 1987 to pay Nearco, Inc. 4% of Kaupulehu Developments' gross receipts from the sale of real estate interests. The fees represent compensation for promotion and marketing of Kaupulehu Developments' property and were determined based on the estimated fair value of such services. Barnwell believes the fees are fair and reasonable compensation for such services.

Costs related to the land under development and costs related to development rights under option are capitalized and included in the Condensed Consolidated Balance Sheets under the caption, "Investment in land." Costs related to leasehold land under development and costs related to development rights under option were \$6,508,000 and zero, respectively, at March 31, 2003.

### 4. NOTE RECEIVABLE

Nearco, Inc.'s note payable to Barnwell was due in full on December 31, 2002. Nearco, Inc. paid all interest due and payable at December 31, 2002 of \$58,000 and repaid approximately \$70,000 of principal on its note payable to Barnwell in January 2003 leaving an unpaid principal balance of approximately \$1,311,000, which is outstanding as of the date of this filing. Under the terms of the note, the note is in default and the rate of interest has increased from 10% to 12% beginning January 1, 2003. Barnwell is evaluating its potential remedies for collection. Nearco, Inc. has paid interest on the note through March 31, 2003. Management believes that Nearco, Inc. will repay its note and any interest due in full. Management estimates that the current value of Nearco, Inc.'s pledged interest in Kaupulehu Developments is significantly in excess of the combined value of its note to Barnwell and Nearco, Inc.'s \$450,000 note to a third party to which Barnwell's note is subordinated.

## 5. SEGMENT INFORMATION

Barnwell operates three segments: exploring for, developing, producing and selling oil and natural gas (oil and natural gas); investing in leasehold land in Hawaii (land investment); and drilling wells and installing and repairing water pumping systems in Hawaii (contract drilling). Barnwell's reportable segments are strategic business units that offer different products and services. They are managed separately as each segment requires different operational methods, operational assets and marketing strategies.

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Barnwell does not allocate general and administrative expenses, interest expense, interest income or income taxes to segments, and there are no transactions between segments that affect segment profit or loss.

|   | Three months ended March 31, |              | Six months ended March 31, |              |
|---|------------------------------|--------------|----------------------------|--------------|
|   | 2003                         | 2002         | 2003                       | 2002         |
| <b>Revenues:</b>  |                              |              |                            |              |
| Oil and natural gas   | \$ 5,140,000                 | \$ 2,530,000 | \$ 8,960,000               | \$ 5,100,000 |
| Contract drilling   | 550,000                      | 940,000      | 1,560,000                  | 2,120,000    |
| Land investment   |                              |              | 720,000                    | 120,000      |
| Other   | 247,000                      | 203,000      | 520,000                    | 310,000      |
| Total before interest income  | 5,937,000                    | 3,673,000    | 11,760,000                 | 7,650,000    |
| Interest income   | 53,000                       | 37,000       | 210,000                    | 70,000       |
| Total revenues  | \$ 5,990,000                 | \$ 3,710,000 | \$ 11,970,000              | \$ 7,720,000 |
| <b>Depreciation, depletion and amortization:</b>                            |                              |              |                            |              |
| Oil and natural gas   | \$ 843,000                   | \$ 761,000   | \$ 1,654,000               | \$ 1,647,000 |
| Contract drilling   | 28,000                       | 30,000       | 62,000                     | 59,000       |
| Other   | 48,000                       | 50,000       | 88,000                     | 103,000      |
| Total   | \$ 919,000                   | \$ 841,000   | \$ 1,804,000               | \$ 1,809,000 |
| <b>Operating profit (loss), before general and administrative expenses:</b> |                              |              |                            |              |
| Oil and natural gas   | \$ 3,377,000                 | \$ 913,000   | \$ 5,309,000               | \$ 1,717,000 |
| Contract drilling   | (59,000)                     | 286,000      | 131,000                    | 603,000      |
| Land investment, net of minority interest                                   | 42,000                       | 1,000        | 365,000                    | 1,000        |
| Other   | 199,000                      | 153,000      | 432,000                    | 207,000      |
| Total   | 3,559,000                    | 1,353,000    | 6,237,000                  | 2,528,000    |
| General and administrative expenses   | (1,614,000)                  | (1,042,000)  | (3,048,000)                | (2,025,000)  |
| Interest expense  | (122,000)                    | (77,000)     | (202,000)                  | (137,000)    |
| Interest income   | 53,000                       | 37,000       | 210,000                    | 70,000       |
| Earnings before income taxes  | \$ 1,876,000                 | \$ 271,000   | \$ 3,197,000               | \$ 436,000   |

## 6. INCOME TAXES

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The components of the provision for income taxes for the three and six months ended March 31, 2003 and 2002 are as follows:

|                       | Three months ended<br>March 31, |                   | Six months ended<br>March 31, |                   |
|-----------------------|---------------------------------|-------------------|-------------------------------|-------------------|
|                       | 2003                            | 2002              | 2003                          | 2002              |
| Current U.S.          | \$ 10,000                       | \$                | \$ 76,000                     | \$ 18,000         |
| Current Foreign       | 1,316,000                       | 351,000           | 2,062,000                     | 607,000           |
| <b>Total Current</b>  | <b>1,326,000</b>                | <b>351,000</b>    | <b>2,138,000</b>              | <b>625,000</b>    |
| Deferred U.S.         | 80,000                          | 130,000           | (240,000)                     | (145,000)         |
| Deferred Foreign      | 170,000                         |                   | 129,000                       | 16,000            |
| <b>Total Deferred</b> | <b>250,000</b>                  | <b>130,000</b>    | <b>(111,000)</b>              | <b>(129,000)</b>  |
|                       | <b>\$ 1,576,000</b>             | <b>\$ 481,000</b> | <b>\$ 2,027,000</b>           | <b>\$ 496,000</b> |

Included in the provisions for deferred income taxes for the six months ended March 31, 2003 and 2002 are U.S. deferred tax benefits of \$320,000 and \$376,000, respectively, related to the sale of land development rights in December 2002 and 2001, respectively. The sales of land development rights created temporary differences due to the excess of expenses recognized under the cost recovery method

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for books over expenses deductible for tax purposes. There were no such deferred tax benefits in the three months ended March 31, 2003 and 2002.

In April 2002, the legislative assembly of the Province of Alberta passed a bill to reduce the province's corporate tax rate from 13.5% to 13.0%, effective April 1, 2002. The bill was enacted into law in December 2002. The reduction in the tax rate reduced Canadian deferred income taxes liabilities by approximately \$75,000 in the three months ended December 31, 2002 and six months ended March 31, 2003. There was no such reduction in the three months ended March 31, 2003 or in the three and six months ended March 31, 2002.

The provision for income taxes did not bear a normal relationship to earnings before income taxes because Canadian taxes were payable on Canadian operations and losses from U.S. operations provide no foreign tax benefits.

### 7. PROPERTY AND EQUIPMENT AND ASSET RETIREMENT OBLIGATION

On October 1, 2002, Barnwell adopted Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations," which requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. Barnwell's estimated site restoration and abandonment costs of its oil and natural gas properties are capitalized as part of the carrying amount of oil and natural gas properties and depleted over the life of the related reserves. Adoption of SFAS No. 143 increased both net oil and natural gas properties and the asset retirement obligation by \$1,110,000 on October 1, 2002. The liability is accreted at the end of each period through charges to oil and natural gas operating expense. If the obligation is settled for other than the carrying amount of the liability, Barnwell will recognize a gain or loss on settlement.

Following the initial implementation of SFAS No. 143, the asset retirement obligation was increased during the six months ended March 31, 2003 by \$74,000 to reflect obligations incurred on new wells drilled, by \$40,000 for accretion of the asset retirement obligation, and by \$90,000 for changes in foreign currency translation rates.

### 8. STOCK-BASED COMPENSATION

Barnwell applies the provisions of Accounting Principles Board Opinion No. 25 in accounting for stock-based compensation and adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation." Had compensation cost for stock options granted since October 1, 1995 been determined based on the fair value method of measuring stock-based

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compensation provisions of Statement of Financial Accounting Standards No. 123, Barnwell's net earnings (loss) and basic and diluted earnings (loss) per share would have been as follows:

|  | Three months ended<br>March 31, |              | Six months ended<br>March 31, |              |
|--|---------------------------------|--------------|-------------------------------|--------------|
|  | 2003                            | 2002         | 2003                          | 2002         |
| Net earnings (loss), as reported   | \$ 300,000                      | \$ (210,000) | \$ 1,170,000                  | \$ (60,000)  |
| Less stock-based employee compensation expense determined under the fair value based method, net of related income taxes | (12,000)                        | (24,000)     | (22,000)                      | (48,000)     |
| Pro-forma net earnings (loss)  | \$ 288,000                      | \$ (234,000) | \$ 1,148,000                  | \$ (108,000) |
| Basic Earnings (Loss) Per Share:   |                                 |              |                               |              |
| As reported  | \$ 0.23                         | \$ (0.16)    | \$ 0.89                       | \$ (0.05)    |
| Pro forma  | \$ 0.22                         | \$ (0.18)    | \$ 0.87                       | \$ (0.08)    |
| Diluted Earnings (Loss) Per Share:   |                                 |              |                               |              |
| As reported  | \$ 0.22                         | \$ (0.16)    | \$ 0.86                       | \$ (0.05)    |
| Pro forma  | \$ 0.21                         | \$ (0.18)    | \$ 0.84                       | \$ (0.08)    |

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### 9. RECENT ACCOUNTING PRONOUNCEMENTS

In November 2002, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of FIN No. 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FIN No. 45 did not have a material effect on Barnwell's financial condition, results of operations or liquidity.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities," which addresses the consolidation of variable interest entities ("VIE") as defined. FIN No. 46 applies immediately to variable interests in VIEs created after January 31, 2003, and to variable interests in VIEs obtained after January 31, 2003. For a variable interest in a VIE acquired before February 1, 2003, FIN No. 46 is to be applied no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003. The application of FIN No. 46 did not have a material effect on Barnwell's financial condition, results of operations or liquidity.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments to SFAS No. 123 are effective for financial statements for fiscal years ending after December 15, 2002. The required disclosures for interim financial statements are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. The adoption of SFAS No. 148 did not have a material effect on Barnwell's financial condition, results of operations or liquidity.

### Item 2. Management's Discussion and Analysis or Plan of Operation

## FORWARD-LOOKING STATEMENTS

This Form 10-QSB contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including various forecasts, projections of Barnwell's future performance, statements of Barnwell's plans and objectives or other similar types of information. Although Barnwell believes that its expectations are based on reasonable assumptions, it cannot assure that the expectations contained in such forward-looking statements will be achieved. Such statements involve risks, uncertainties and assumptions which could cause actual results to differ materially from those contained in such statements. These forward-looking statements speak only as of the date of filing of this Form 10-QSB, and Barnwell expressly disclaims any obligation or undertaking to publicly release any updates or revisions to any forward-looking statements contained herein.

## CRITICAL ACCOUNTING POLICIES

In response to the Securities and Exchange Commission's Release No. 33-8040, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies," Barnwell identifies its most critical accounting principles upon which its financial reporting is based as the full cost method of accounting for oil and natural gas properties, the accounting for investment in land, the percentage of completion method of accounting for contract drilling and valuation of receivables. These accounting policies are stated in the notes to the consolidated financial statements included in Barnwell's annual report on Form 10-KSB for the year ended September 30, 2002 and in relevant sections in this discussion and analysis.

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## CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

Please see Notes 4, 6, 8 and 10 of the "Notes to the Consolidated Financial Statements" in Barnwell's annual report on Form 10-KSB for the year ended September 30, 2002.

## LIQUIDITY AND CAPITAL RESOURCES

Cash flows provided by operations totaled \$3,488,000 for the six months ended March 31, 2003, an increase of \$5,094,000 as compared to \$1,606,000 of cash flows used in operations for the same period in the prior year. This increase was primarily due to higher operating profit generated by Barnwell's oil and natural gas segment as a result of higher petroleum prices, and a decrease in income taxes paid in the current period, as compared to the same period in the prior year. Income taxes of \$2,901,000 were paid in the six months ended March 31, 2002 (primarily related to income taxes for the year ended September 30, 2001, which were paid, when due, in the first quarter of fiscal 2002), as compared to \$830,000 for the six months ended March 31, 2003.

On December 31, 2002, Kaupulehu Makai Venture exercised the portion of its development rights option due on that date and paid Kaupulehu Developments, Barnwell's 77.6% owned land development partnership, \$2,125,000. Barnwell accounts for sales of development rights under option by use of the cost recovery method. Under the cost recovery method, no operating profit is recognized until cash received exceeds the cost and the estimated future costs related to development rights sold. Accordingly, in consolidation, \$1,277,000 of the proceeds from the sales of development rights were applied to reduce the carrying value of the underlying investment in land to zero. Additionally, sales of development rights were further reduced by approximately \$128,000 of fees related to the sale. The remaining \$720,000 of sales proceeds is recorded in the Consolidated Statements of Operations for the six months ended March 31, 2003 as "Sale of development rights, net." There were no sales of development rights in the three months ended March 31, 2003.

At March 31, 2003, Barnwell had \$1,886,000 in cash and cash equivalents, and approximately \$3,000,000 of available credit under its credit facility with its principal bank.

Barnwell invested cash of \$2,236,000 and \$4,111,000 in oil and natural gas properties during the three and six months ended March 31, 2003, respectively, as compared to cash of \$1,178,000 and \$2,582,000 for the three and six months ended March 31, 2002, respectively. Additionally, for the three and six months ended March 31, 2003, Barnwell committed to an additional \$900,000 in oil and natural gas capital expenditures.

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The following table sets forth the gross and net number of exploratory ("Exp.") and development ("Dev.") wells drilled for the three and six months ended March 31, 2003 and 2002 in which Barnwell participated:

### Three months ended March 31,

|             | Productive Oil Wells |      | Productive Gas Wells |      | Dry Holes |      | Total Wells |      |
|-------------|----------------------|------|----------------------|------|-----------|------|-------------|------|
|             | Exp.                 | Dev. | Exp.                 | Dev. | Exp.      | Dev. | Exp.        | Dev. |
| <b>2003</b> |                      |      |                      |      |           |      |             |      |
| Gross*      |                      | 5.00 | 3.00                 | 3.00 | 2.00      | 1.00 | 5.00        | 9.00 |
| Net*        |                      | 1.52 | 0.60                 | 0.96 | 0.46      | 0.35 | 1.06        | 2.83 |
| 2002        |                      |      |                      |      |           |      |             |      |
| Gross*      | 1.00                 | 2.00 |                      | 2.00 | 1.00      |      | 2.00        | 4.00 |
| Net*        | 0.25                 | 0.82 |                      | 0.63 | 0.55      |      | 0.80        | 1.45 |

### Six months ended March 31,

|             | Productive Oil Wells |      | Productive Gas Wells |      | Dry Holes |      | Total Wells |       |
|-------------|----------------------|------|----------------------|------|-----------|------|-------------|-------|
|             | Exp.                 | Dev. | Exp.                 | Dev. | Exp.      | Dev. | Exp.        | Dev.  |
| <b>2003</b> |                      |      |                      |      |           |      |             |       |
| Gross*      |                      | 5.00 | 3.00                 | 9.00 | 3.00      | 1.00 | 6.00        | 15.00 |
| Net*        |                      | 1.52 | 0.60                 | 2.79 | 0.86      | 0.35 | 1.46        | 4.66  |
| 2002        |                      |      |                      |      |           |      |             |       |
| Gross*      | 1.00                 | 2.00 |                      | 5.00 | 1.00      |      | 2.00        | 7.00  |
| Net*        | 0.25                 | 0.82 |                      | 1.98 | 0.55      |      | 0.80        | 2.80  |

\*

The term "Gross" refers to the total number of wells in which Barnwell owns an interest, and "Net" refers to Barnwell's aggregate interest therein. For example, a 50% interest in a well represents 1 gross well, but 0.50 net well. The gross figure includes interests owned of record by Barnwell and in addition the portion owned by others.

Fifteen of the 21 wells Barnwell participated in drilling during the six months ended March 31, 2003 were on prospects developed by Barnwell. In last year's first six months, 7 of the 9 wells Barnwell participated in drilling were on prospects developed by Barnwell.

Barnwell believes its current cash balances, future cash flows from operations, land segment sales, collection of receivables, and available credit will be sufficient to fund its estimated capital expenditures, make the \$180,000 of scheduled repayments on its debentures in fiscal 2003, and meet the repayment schedule on its Royal Bank of Canada facility, should Barnwell or the Royal Bank of Canada elect to convert the facility to a term loan. However, if oil and natural gas production remains at or declines from current levels or oil and natural gas prices decline from current levels, current working capital balances and cash flows generated by operations may not be sufficient to fund Barnwell's current projected level of oil and natural gas capital expenditures, in which case Barnwell may fund capital expenditures with funds generated by land segment sales, long-term debt borrowings, or it may reduce future oil and natural gas capital expenditures. Additionally, if Barnwell's credit facility with a Canadian bank is reduced below the current level of borrowings under the facility after the 2003 review, expected to be completed in fiscal 2003, Barnwell may be required to reduce expenditures or seek alternative sources of financing to make any required payments under the facility.

## RESULTS OF OPERATIONS

### Summary/General

For the three and six months ended March 31, 2003, Barnwell reported net earnings of \$300,000 and \$1,170,000, respectively, as compared to net losses of \$210,000 and \$60,000 for the same periods in the prior fiscal year. The increase is largely attributable to significant increases in petroleum prices. In

addition, land segment operating profit increased in the six months ended March 31, 2003, as compared to the same period in the prior year, as revenues from the sale of development rights (accounted for under the cost recovery method) exceeded associated costs in the current year period, whereas revenues from the sale of development rights in the prior year period were fully offset by associated costs (after consideration of minority interest in earnings).

If weather in North America or other factors bring about lower natural gas and/or oil prices or Barnwell is not successful in increasing its production of petroleum products or Barnwell does not have additional earnings from its land investment segment this year, Barnwell may incur losses in the remaining quarters of fiscal 2003.

The following tables set forth Barnwell's net production and average price per unit of production for the three and six months ended March 31, 2003 as compared to the three and six months ended March 31, 2002. Production amounts reported are net of royalties and the Alberta Royalty Tax Credit.

*Oil and Natural Gas*

**SELECTED OPERATING STATISTICS**

|                 | Average Prices                  |          |          |      |
|-----------------|---------------------------------|----------|----------|------|
|                 | Three months ended<br>March 31, |          | Increase |      |
|                 | 2003                            | 2002     | \$       | %    |
|                 |                                 |          |          |      |
| Oil (Bbls)*     | \$ 30.94                        | \$ 19.22 | \$ 11.72 | 61%  |
| Liquids (Bbls)* | \$ 23.41                        | \$ 9.05  | \$ 14.36 | 159% |
| Gas (MCF)**     | \$ 5.08                         | \$ 2.00  | \$ 3.08  | 154% |

|                 | Average Prices                |          |          |      |
|-----------------|-------------------------------|----------|----------|------|
|                 | Six months ended<br>March 31, |          | Increase |      |
|                 | 2003                          | 2002     | \$       | %    |
|                 |                               |          |          |      |
| Oil (Bbls)*     | \$ 28.03                      | \$ 17.38 | \$ 10.65 | 61%  |
| Liquids (Bbls)* | \$ 22.23                      | \$ 10.80 | \$ 11.43 | 106% |
| Gas (MCF)**     | \$ 4.14                       | \$ 1.98  | \$ 2.16  | 109% |

|                 | Net Sales Volumes               |         |                        |       |
|-----------------|---------------------------------|---------|------------------------|-------|
|                 | Three months ended<br>March 31, |         | Increase<br>(Decrease) |       |
|                 | 2003                            | 2002    | Units                  | %     |
|                 |                                 |         |                        |       |
| Oil (Bbls)*     | 33,000                          | 36,000  | (3,000)                | (8)%  |
| Liquids (Bbls)* | 22,000                          | 21,000  | 1,000                  | 5%    |
| Gas (MCF)**     | 707,000                         | 794,000 | (87,000)               | (11)% |

|  | Net Sales Volumes             |          |
|--|-------------------------------|----------|
|  | Six months ended<br>March 31, | Decrease |

|                 | Net Sales Volumes |           |           |       |
|-----------------|-------------------|-----------|-----------|-------|
|                 | 2003              | 2002      | Units     | %     |
| Oil (Bbls)*     | 70,000            | 72,000    | (2,000)   | (3)%  |
| Liquids (Bbls)* | 40,000            | 47,000    | (7,000)   | (15)% |
| Gas (MCF)**     | 1,465,000         | 1,690,000 | (225,000) | (13)% |

\*

Bbls = stock tank barrel equivalent to 42 U.S. gallons

\*\*

MCF = 1,000 cubic feet

Oil and natural gas revenues increased \$2,610,000 (103%) and \$3,860,000 (76%) for the three and six months ended March 31, 2003, respectively, as compared to the same periods the prior year, due to

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significant increases in natural gas, oil and natural gas liquids prices, partially offset by decreases in production due to declines at certain of Barnwell's more mature properties.

Additionally, due to a fire in early October 2002 at a Dunvegan gas plant, natural gas liquids were not stripped out of the natural gas resulting in an approximately 6,000 barrel decline in liquids net production for the six months ended March 31, 2003. Barnwell did, however, receive a higher price for its natural gas than it would have if the liquids had been removed, thereby mitigating some of the impact of the liquids production decline. The damage to the gas plant was repaired and the plant resumed operations in late December 2002.

Oil and natural gas operating expenses remained relatively unchanged (increased \$64,000 or 7%) for the three months ended March 31, 2003, as compared to the same period in the prior year.

Oil and natural gas operating expenses increased \$261,000 (15%) for the six months ended March 31, 2003, as compared to the same period in the prior year, due primarily to an increase in well repair and maintenance costs (both on the surface and below that management deemed did not increase production life or reserves). Additionally, Barnwell's electricity costs, property taxes, and insurance costs have increased, and the current year period includes accretion of the asset retirement obligation due to implementation of Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations," on October 1, 2002.

#### *Contract Drilling*

Contract drilling revenues decreased \$390,000 (41%) and \$560,000 (26%), respectively, for the three and six months ended March 31, 2003, and contract drilling costs decreased \$43,000 (7%) and \$91,000 (6%), respectively, for the three and six months ended March 31, 2003, as compared to the same periods in the prior year, due primarily to a decrease in water well drilling activity. Operating profit before general and administrative expenses decreased \$345,000 (121%) and \$472,000 (78%) for the three and six months ended March 31, 2003, respectively, as compared to the same periods in the prior year, due to the decreased activity and also due to lower contract margins resulting from higher competition for a decreased number of available contracts. Management believes that, based on its current contract backlog and current estimate of contracts to be put out for bid, contract drilling revenues and operating profit before general and administrative expenses will decline in the last half of this fiscal year, as compared to the first half of the current fiscal year.

#### *Sale of Development Rights and Minority Interest in Earnings*

On December 31, 2002 and 2001, Kaupulehu Makai Venture exercised the portion of its development rights option due on those dates and paid Kaupulehu Developments \$2,125,000 on each date. Barnwell accounts for sales of development rights under option under the cost recovery method where no operating profit is recognized until cash received exceeds costs and estimated future costs associated with the development rights. In the three months ended December 31, 2001, \$1,877,000 of the balance of investment in land was expensed as a result of this sale and



reduced operating profit, after minority interest, to zero. However, in the three months ended December 31, 2002, the remaining balance of investment in land associated with development rights sold of \$1,277,000 was reduced to zero; thus net revenues from the sale of development rights exceeded the amount of investment in land expensed and resulted in \$280,000 of operating profit, after minority interest, on the transaction. Barnwell also recorded \$320,000 and \$376,000 of deferred income tax benefits in the quarters ended December 31, 2002 and 2001, respectively, related to the temporary difference created by the excess of expenses recognized under the cost recovery method for books over expenses deductible for tax purposes.

Barnwell did not receive any revenues from the sale of development rights in the three months ended March 31, 2003 or 2002 related to its interest in Kaupulehu Developments. The total amount of the remaining option proceeds, if fully exercised, was \$21,250,000 at March 31, 2003, eight payments of \$2,656,250 due on each December 31 of years 2003 to 2010. If any annual option payment is not made, the then remaining development right options will expire. There is no assurance that any portion of the remaining options will be exercised.

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Kaupulehu Developments is negotiating with an independent party interested in developing the approximately 870 acres of resort/residential leasehold acreage (of which approximately 186 acres were designated by the State Land Use Commission as preservation areas with no residential or golf course development) and continues to negotiate a revised development agreement and residential fee simple purchase prices with the lessor. Management cannot predict the outcome of these negotiations.

#### *Gas Processing and Other*

Gas processing and other income increased \$60,000 (25%) and \$350,000 (92%) for the three and six months ended March 31, 2003, respectively, as compared to the same periods in 2002, principally due to the receipt of \$50,000 and \$200,000 in income during the three and six months ended March 31, 2003, respectively, by Kaupulehu Developments, Barnwell's 77.6% owned land development partnership. There was no such income in the three and six months ended March 31, 2002. Additionally, interest income for the six months ended March 31, 2003 increased due to \$102,000 of interest on an income tax refund from the Canadian government relating to Barnwell's fiscal 1994 tax return. There was no such item in the six months ended March 31, 2002.

#### *General and Administrative Expenses*

General and administrative expenses increased \$572,000 (55%) and \$1,023,000 (51%) for the three and six months ended March 31, 2003, as compared to the same periods in 2002, due primarily to ongoing negotiations and other costs related to Kaupulehu Developments' leasehold land with interested parties. Such costs, totaling approximately \$225,000 and \$436,000 for the three and six months ended March 31, 2003, respectively, consisted of legal, consulting, travel and other costs. The increase was also attributable to i) the cost of legal services of approximately \$24,000 and \$72,000 (to comply with the Sarbanes-Oxley Act of 2002, amend the Audit Committee Charter and restate the Barnwell Industries, Inc. Employees' Pension Plan to comply with Internal Revenue Service rulings) for the three and six months ended March 31, 2003, respectively, ii) increased stock appreciation rights expense of \$134,000 and \$65,000 for the three and six months ended March 31, 2003, respectively, iii) increased personnel and oil and natural gas segment incentive plan costs of approximately \$60,000 and \$190,000 for the three and six months ended March 31, 2003, respectively, iv) increased audit, tax and pension plan professional services of approximately \$64,000 and \$73,000 for the three and six months ended March 31, 2003, respectively, and v) increases in other expenses and general inflationary increases.

#### *Depletion, Depreciation and Amortization*

Depletion, depreciation and amortization increased \$78,000 (9%) for the three months ended March 31, 2003, as compared to the same period in the prior year, due primarily to a 21% increase in the depletion rate, partially offset by a decrease in natural gas and oil production.

Depletion, depreciation and amortization remained essentially unchanged (decreased \$5,000) for the six months ended March 31, 2003, as compared to the same period in the prior year, due primarily to a decrease in production which was offset by a 17% increase in the depletion rate.

#### *Interest Expense*

Interest expense increased \$45,000 (58%) and \$65,000 (47%) for the three and six months ended March 31, 2003, respectively, as compared to the same periods in fiscal 2002, due to higher average loan balances and decreased capitalized interest, partly offset by lower average interest rates. Development of Kaupulehu Developments' leasehold land interests in approximately 870 acres of land zoned for resort/residential development was substantially complete as of the end of December 2002. Accordingly, effective January 1, 2003, Barnwell no

longer capitalizes interest on the accumulated development costs of the property.

#### *Income Taxes*

Included in the provisions for deferred income taxes for the six months ended March 31, 2003 and 2002 are U.S. deferred tax benefits of \$320,000 and \$376,000, respectively, related to the sale of land development rights in December 2002 and 2001, respectively. The sales of land development rights

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created temporary differences due to the excess of expenses recognized under the cost recovery method for books over expenses deductible for tax purposes. There was no such deferred income tax benefit recorded in the three months ended March 31, 2003 and 2002.

In April 2002, the legislative assembly of the Province of Alberta passed a bill to reduce the province's corporate tax rate from 13.5% to 13.0%, effective April 1, 2002. The bill was enacted into law in December 2002. The reduction in the tax rate reduced Canadian deferred income taxes liabilities by approximately \$75,000 in the three months ended December 31, 2002 and six months ended March 31, 2003. There was no such reduction in the three months ended March 31, 2003 or three and six months ended March 31, 2002.

The provision for income taxes did not bear a normal relationship to earnings before income taxes because Canadian taxes were payable on Canadian operations and losses from U.S. operations provide no foreign tax benefits.

#### *Other Comprehensive Income*

Other comprehensive income for the three and six months ended March 31, 2003 was \$1,004,000 and \$1,044,000, respectively, due to an increase in the value of the Canadian dollar against the U.S. dollar. The Canadian dollar exchange rate increased approximately 7.6% and 8.0% during the three and six months ended March 31, 2003, respectively.

### **Item 3. Controls and Procedures**

Within the 90-day period prior to the filing of this report, an evaluation was carried out by Barnwell's Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that Barnwell's disclosure controls and procedures are effective to ensure that information required to be disclosed by Barnwell in reports that it files or submits under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Subsequent to the date of their evaluation, there were no significant changes in Barnwell's internal controls or in other factors that could significantly affect the disclosure controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

## **PART II. OTHER INFORMATION**

### **Item 4. Submission of Matters to a Vote of Security Holders**

- (a) The 2003 Annual Meeting of Stockholders of the registrant was held on March 3, 2003.
- (b) At the 2003 Annual Meeting the following were elected as directors:

| <b>Director</b>          | <b>For</b> | <b>Abstain</b> |
|--------------------------|------------|----------------|
| Morton H. Kinzler        | 1,107,113  | 105,463        |
| Alan D. Hunter           | 1,107,113  | 105,463        |
| Erik Hazelhoff-Roelfzema | 1,107,113  | 105,463        |
| Daniel Jacobson          | 1,107,113  | 105,463        |

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| Director             | For       | Abstain |
|----------------------|-----------|---------|
| Martin Anderson      | 1,107,113 | 105,463 |
| Murray C. Gardner    | 1,107,113 | 105,463 |
| Alexander C. Kinzler | 1,107,113 | 105,463 |
| Terry Johnston       | 1,107,113 | 105,463 |
| Russell M. Gifford   | 1,107,113 | 105,463 |

**Item 6. Exhibits and reports on Form 8-K**

- (a) Exhibits

Exhibit No. 99.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted by Section 906 of the Sarbanes-Oxley Act of 2002.

- (b) Reports on Form 8-K

None.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BARNWELL INDUSTRIES, INC.

\_\_\_\_\_  
(Registrant)

/s/ RUSSELL M. GIFFORD

\_\_\_\_\_  
Russell M. Gifford  
*Executive Vice President and  
Chief Financial Officer*

Date: May 13, 2003

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**CERTIFICATIONS**

I, Russell M. Gifford, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Barnwell Industries, Inc.;

- 2.

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Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3.

Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4.

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a)

designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b)

evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c)

presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5.

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a)

all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b)

any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6.

The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

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/s/ RUSSELL M. GIFFORD

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Russell M. Gifford  
*Chief Financial Officer*

I, Morton H. Kinzler, certify that:

1.

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I have reviewed this quarterly report on Form 10-QSB of Barnwell Industries, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

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/s/ MORTON H. KINZLER

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Morton H. Kinzler  
*Chief Executive Officer*

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