

BARNWELL INDUSTRIES INC  
Form 10-K  
December 12, 2012  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

(Mark One)

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

**For the fiscal year ended September 30, 2012**

or

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

**Commission File Number 1-5103**

**BARNWELL INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(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)

**96813-2833**

(Zip code)

Registrant's telephone number, including area code: **(808) 531-8400**

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

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| <u>Title of each class</u>               | <u>Name of each exchange on which registered</u> |
|------------------------------------------|--------------------------------------------------|
| Common Stock, par value \$0.50 per share | NYSE MKT                                         |

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

☐ Yes ☒ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

☒ Yes ☐ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

☒ X

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☒ X

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

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The aggregate market value of the voting common stock held by non-affiliates of the registrant, computed by reference to the closing price of a share of common stock on March 31, 2012 (the last business day of the registrant's most recently completed second fiscal quarter) was \$11,756,000.

As of December 1, 2012 there were 8,277,160 shares of common stock outstanding.

### Documents Incorporated by Reference

1. Proxy statement to be forwarded to stockholders on or about January 20, 2013 is incorporated by reference in Part III hereof.
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**GLOSSARY OF TERMS**

Defined below are certain terms used in this Form 10-K:

| Terms              | Definitions                                                                                                                                                                                                                                                                                                                                                                                                           |
|--------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ASC                | Accounting Standards Codification                                                                                                                                                                                                                                                                                                                                                                                     |
| Barnwell           | Barnwell Industries, Inc. and all majority-owned subsidiaries                                                                                                                                                                                                                                                                                                                                                         |
| Barnwell of Canada | Barnwell of Canada, Limited                                                                                                                                                                                                                                                                                                                                                                                           |
| Bbl(s)             | stock tank barrel(s) of oil equivalent to 42 U.S. gallons                                                                                                                                                                                                                                                                                                                                                             |
| Boe                | barrel of oil equivalent at the rate of 5.8 Mcf per Bbl of oil or NGL                                                                                                                                                                                                                                                                                                                                                 |
| FASB               | Financial Accounting Standards Board                                                                                                                                                                                                                                                                                                                                                                                  |
| GAAP               | U.S. generally accepted accounting principles                                                                                                                                                                                                                                                                                                                                                                         |
| Gross              | Total number of acres or wells in which Barnwell owns an interest; includes interests owned of record by Barnwell and, in addition, the portion(s) owned by others; for example, a 50% interest in a 320 acre lease represents 320 gross acres and a 50% interest in a well represents 1 gross well. In the context of production volumes, gross represents amounts before deduction of the royalty share due others. |
| Hualalai Investors | Hualalai Investors JV, LLC and Hualalai Investors II, LLC, collectively                                                                                                                                                                                                                                                                                                                                               |
| InSite             | InSite Petroleum Consultants Ltd. (formerly Paddock Lindstrom & Associates Ltd.)                                                                                                                                                                                                                                                                                                                                      |
| Kaupulehu 2007     | Kaupulehu 2007, LLLP                                                                                                                                                                                                                                                                                                                                                                                                  |
| LIBOR              | London Interbank Offer Rate                                                                                                                                                                                                                                                                                                                                                                                           |
| Mcf                | 1,000 cubic feet of natural gas at 14.65 pounds per square inch absolute and 60 degrees Fahrenheit                                                                                                                                                                                                                                                                                                                    |
| Mcf <sub>e</sub>   | Mcf equivalent at the rate of 1 Bbl = 5.8 Mcf                                                                                                                                                                                                                                                                                                                                                                         |
| Net                | Barnwell's aggregate interest in the total acres or wells; for example, a 50% interest in a 320 acre lease represents 160 net acres and a 50% interest in a well represents 0.5 net well. In the context of production volumes, net represents amounts after                                                                                                                                                          |

deduction of the royalty share due others.

NGL(s)

natural gas liquid(s)

SEC

United States Securities and Exchange Commission

Water Resources

Water Resources International, Inc.

WB

WB KD Acquisition, LLC

WBKD

WB KD Acquisition II, LLC

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**PART I**

**CAUTIONARY STATEMENT RELEVANT TO FORWARD-LOOKING INFORMATION  
FOR THE PURPOSE OF SAFE HARBOR PROVISIONS OF THE  
PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

*This Form 10-K, and the documents incorporated herein by reference, contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. A forward-looking statement is one which is based on current expectations of future events or conditions and does not relate to historical or current facts. These statements include various estimates, forecasts, projections of Barnwell Industries, Inc.'s (referred to herein together with its subsidiaries as Barnwell, we, our, us or the Company) future performance, statements of Barnwell's plans and objectives and other similar statements. Forward-looking statements include phrases such as expects, anticipates, intends, plans, believes, predicts, estimates, assumes, projects, may, will, will be, should, or similar expressions. Although Barnwell believes that its current expectations are based on reasonable assumptions, it cannot assure that the expectations contained in such forward-looking statements will be achieved. Forward-looking statements involve risks, uncertainties and assumptions which could cause actual results to differ materially from those contained in such statements. Investors should not place undue reliance on these forward-looking statements, as they speak only as of the date of filing of this Form 10-K, and Barnwell expressly disclaims any obligation or undertaking to publicly release any updates or revisions to any forward-looking statements contained herein.*

*Among the important factors that could cause actual results to differ materially from those in the forward-looking statements are domestic and international general economic conditions, such as recessionary trends and inflation; domestic and international political, legislative, economic, regulatory and legal actions, including changes in the policies of the Organization of Petroleum Exporting Countries or other developments involving or affecting oil-producing countries; military conflict, embargoes, internal instability or actions or reactions of the governments of the United States and/or Canada in anticipation of or in response to such developments; interest costs, restrictions on production, restrictions on imports and exports in both the United States and Canada, the maintenance of specified reserves, tax increases and retroactive tax claims, royalty increases, expropriation of property, cancellation of contract rights, environmental protection controls, environmental compliance requirements and laws pertaining to workers' health and safety; the condition of Hawaii's real estate market, including the level of real estate activity and prices, the demand for new housing and second homes on the island of Hawaii, the rate of increase in the cost of building materials and labor, the introduction of building code modifications, changes to zoning laws, the condition of Hawaii's tourism industry and the level of confidence in Hawaii's economy; levels of land development activity in Hawaii; levels of demand for water well drilling and pump installation in Hawaii; the potential liability resulting from pending or future litigation; the Company's acquisition or disposition of assets; the effects of changed accounting rules under GAAP promulgated by rule-setting bodies; and the factors set forth under the heading Risk Factors in*

*this Form 10-K, in other portions of this Form 10-K, in the Notes to Consolidated Financial Statements, and in other documents filed by Barnwell with the SEC. In addition, unpredictable or unknown factors not discussed in this report could also cause actual results to materially and adversely differ from those discussed in the forward-looking statements.*

Unless otherwise indicated, all references to dollars in this Form 10-K are to United States dollars.

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**ITEM 1. BUSINESS**

**Overview**

Barnwell was incorporated in Delaware in 1956 and fiscal 2012 represented Barnwell's 56th year of operations. Barnwell operates in the following four principal business segments:

- *Oil and Natural Gas Segment.* Barnwell engages in oil and natural gas exploration, development, production and sales in Canada.
- *Land Investment Segment.* Barnwell invests in land interests in Hawaii.
- *Contract Drilling Segment.* Barnwell provides well drilling services and water pumping system installation and repairs in Hawaii.
- *Residential Real Estate Segment.* Barnwell develops homes for sale in Hawaii.

**Oil and Natural Gas Segment**

*Overview*

Through our wholly-owned subsidiary, Barnwell of Canada, we are involved in the acquisition, exploration and development of oil and natural gas properties. Barnwell of Canada initiates and participates in exploratory and developmental operations for oil and natural gas on properties in which it has an interest and evaluates proposals by third parties with regard to participation in such exploratory and developmental operations elsewhere.

### *Operations*

Barnwell's investments in oil and natural gas properties are located in Canada, principally in the province of Alberta, with lesser holdings in the provinces of Saskatchewan and British Columbia. These property interests are principally held under governmental leases or licenses. Under the typical Canadian provincial governmental lease, Barnwell must perform exploratory operations and comply with certain other conditions. Lease terms vary with each province, but, in general, the terms grant Barnwell the right to remove oil, natural gas and related substances subject to payment of specified royalties on production.

All exploratory and developmental operations are overseen by Barnwell's Calgary, Alberta staff and Barnwell's Chief Operating Officer located in Honolulu, along with senior management and independent petroleum reserve engineers as necessary. In fiscal 2012, Barnwell participated in exploratory and developmental operations in Alberta and Saskatchewan, although Barnwell does not limit its consideration of exploratory and developmental operations to these areas.

Natural gas prices are typically higher in the winter than at other times due to increased heating demand. Oil prices are also subject to seasonal fluctuations, but to a lesser degree. Oil and natural gas unit sales are based on the quantity produced from the properties by the properties' operator.

### *Key Property*

Barnwell's principal oil and natural gas property is located in the Dunvegan area of Alberta, Canada and is called the Dunvegan Unit. Barnwell holds an 8.9% working interest in the Dunvegan Unit which, at September 30, 2012, had 220 producing natural gas wells. There were no wells drilled in the Dunvegan Unit in fiscal 2012.

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In fiscal 2012, Dunvegan contributed 67% of Barnwell's net natural gas production, 88% of Barnwell's net natural gas liquids production, and 1% of Barnwell's net oil production, representing 55% of the Company's total net production on a Boe basis (403,000 Boe of a total 734,000 Boe). In fiscal 2012, Dunvegan contributed 30% of Barnwell's oil and natural gas revenues.

Dunvegan's proved natural gas reserves represented 6,129,000 net Mcf or 55% of our total proved natural gas reserves as of September 30, 2012. Dunvegan's proved oil and natural gas liquids reserves represented 216,000 net Bbl or 20% of our total proved oil and natural gas liquids reserves as of September 30, 2012. In total as of September 30, 2012, Dunvegan's reserves represented 43% of the Company's total net reserves on an Mcfe basis.

*Preparation of Reserves Estimates*

Barnwell's reserves are estimated by our independent petroleum reserve engineers, InSite. All information with respect to the Company's reserves in this Form 10-K is derived from the report of InSite. A copy of the report issued by InSite is filed with this Form 10-K as Exhibit 99.1. InSite has been the Company's independent petroleum reserve engineers for over 20 years.

The preparation of data used by the independent petroleum reserve engineers to compile our oil and natural gas reserves estimates is completed in accordance with various internal control procedures which include verification of data input into reserves evaluation software, reconciliations and reviews of data provided to the independent petroleum reserve engineers to ensure completeness, and management review controls, including an independent internal review of the final reserve report for completeness and accuracy.

Barnwell has a Reserves Committee consisting of four independent directors, the Company's President and Chief Operating Officer, and the Company's Executive Vice President and Chief Financial Officer. The Reserves Committee was established to ensure the independence of the Company's petroleum reserve engineers. The Reserves Committee is responsible for reviewing the annual reserve evaluation report prepared by the independent petroleum reserve engineering firm and ensuring that the reserves are reported fairly in a manner consistent with industry standards. The Reserves Committee meets annually to discuss reserves issues and policies and to meet with Company personnel and our independent petroleum reserve engineers.

Barnwell of Canada's President and Chief Operating Officer has primary responsibility for overseeing the preparation of the Company's reserves estimates by our independent petroleum reserve engineers; he is a licensed professional engineer with over 34 years of experience in all facets of the oil and natural gas industry both in Canada and

internationally and is a member of the Association of Professional Engineers and Geoscientists of Alberta.

*Reserves*

The amounts set forth in the following table, prepared by InSite, summarize our estimated proved reserves of oil (including natural gas liquids) and natural gas as of September 30, 2012 on all properties in which Barnwell has an interest. All of Barnwell's proved reserves are developed; Barnwell has no proved undeveloped reserves as of September 30, 2012. All of our oil and natural gas reserves are located in Canada. These reserves are before deductions for indebtedness secured by the

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properties and are based on constant dollars. No estimates of total proved net oil or natural gas reserves have been filed with or included in reports to any federal authority or agency, other than the SEC, since October 1, 2011.

|                                           | September 30, 2012 |
|-------------------------------------------|--------------------|
| Oil, including natural gas liquids (Bbls) | 1,078,000          |
| Natural gas (Mcf)                         | 11,109,000         |
| Total (Boe)                               | 2,993,000          |

During fiscal 2012, Barnwell's total net proved developed reserves, including proved developed producing reserves, of oil and natural gas liquids decreased by 106,000 Bbls (9%) and total net proved developed reserves of natural gas decreased by 3,834,000 Mcf (26%).

*Standardized Measure of Discounted Future Net Cash Flows*

The following table sets forth Barnwell's Estimated Future Net Revenues from total proved oil, natural gas and natural gas liquids reserves and the present value of Barnwell's Estimated Future Net Revenues (discounted at 10%). Estimated future net revenues for total proved reserves are net of estimated future expenditures of developing and producing the proved reserves, and assume the continuation of existing economic conditions. Net revenues have been calculated using the average first-day-of-the-month price during the 12-month period ending in the reporting period and current costs, after deducting all royalties, operating costs, future estimated capital expenditures (including abandonment costs), and income taxes.

|                                                          |                |
|----------------------------------------------------------|----------------|
| Undiscounted future net cash flows, after income taxes   | \$ 47,346,000  |
| Standardized measure of discounted future net cash flows | \$ 35,290,000* |

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\* This amount does not purport to represent, nor should it be interpreted as, the fair value of Barnwell's natural gas and oil reserves. An estimate of fair value would also consider, among other items, the value of Barnwell's undeveloped land position, the recovery of reserves not presently classified as proved, anticipated future changes in oil and natural gas prices (these amounts were based on a natural gas price of \$2.34 per Mcf and an oil price of \$84.14 per Bbl for 2012) and costs, and a discount factor more representative of the time value of money and the risks inherent in reserve estimates.

*Oil and Natural Gas Production*

The following table summarizes (a) Barnwell's net production for the last three fiscal years, based on sales of natural gas, oil and natural gas liquids, from all wells in which Barnwell has or had an interest, and (b) the average sales prices and average production costs for such production during the same periods. Production amounts reported are net of royalties. All of Barnwell's net production in fiscal 2012, 2011 and 2010 was derived in Canada, primarily in Alberta. For a discussion regarding our total annual production volumes, average sales prices, and related production costs, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

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|                                                        | 2012             | Year ended September 30,<br>2011 | 2010      |
|--------------------------------------------------------|------------------|----------------------------------|-----------|
| Annual net production:                                 |                  |                                  |           |
| Natural gas liquids (Bbls)                             | <b>91,000</b>    | 93,000                           | 103,000   |
| Oil (Bbls)                                             | <b>168,000</b>   | 157,000                          | 140,000   |
| Natural gas (Mcf)                                      | <b>2,753,000</b> | 2,950,000                        | 3,245,000 |
| Total (Boe)                                            | <b>734,000</b>   | 759,000                          | 802,000   |
| Annual average sales price per unit of production:     |                  |                                  |           |
| Bbl of natural gas liquids*                            | <b>\$ 46.48</b>  | \$ 49.23                         | \$ 40.05  |
| Bbl of oil*                                            | <b>\$ 83.83</b>  | \$ 84.96                         | \$ 69.55  |
| Mcf of natural gas**                                   | <b>\$ 2.03</b>   | \$ 3.42                          | \$ 3.82   |
| Annual average production cost<br>per Mcfe produced*** | <b>\$ 2.28</b>   | \$ 2.41                          | \$ 1.99   |

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\* Calculated on revenues before royalty expense divided by gross production.

\*\* Calculated on revenues net of pipeline charges before royalty expense divided by gross production.

\*\*\* Calculated on production costs, excluding natural gas pipeline charges, divided by the combined total production of natural gas liquids, oil and natural gas.

## Capital Expenditures

Barnwell invested \$4,915,000 in oil and natural gas properties during fiscal 2012, of which \$496,000 (10%) was for acquisition of oil and natural gas leases, \$1,778,000 (36%) was for exploration costs and \$2,641,000 (54%) was for development of oil and natural gas properties.

Capital expenditures for equipping of wells and acquisition of land totaled \$1,004,000 in the Dunvegan area in fiscal 2012. No wells were drilled in the Dunvegan area in fiscal 2012.

Capital expenditures totaled \$1,784,000 in the Mantario area of Saskatchewan in fiscal 2012. Barnwell acquired 1,373 net acres and drilled four gross (2.3 net) oil wells in fiscal 2012 of which two gross (1.0 net) wells were successful and producing at September 30, 2012 and two gross (1.3 net) wells were dry. Of the dry wells, Barnwell expects to convert one gross (0.7 net) well into a salt water disposal well.

Capital expenditures totaled \$922,000 in the Chigwell area in fiscal 2012. One gross (0.5 net) oil well was drilled in fiscal 2012 which was successful and waiting to be tied in at September 30, 2012.

Capital expenditures totaled \$443,000 in the Wood River area in fiscal 2012. Three gross (0.2 net) oil wells drilled in fiscal 2012 were successful and on production at September 30, 2012.

#### *Well Drilling Activities*

During fiscal 2012, Barnwell participated in the drilling of seven development wells, five of which are producing or management believes should be capable of production. Of the two dry holes, Barnwell expects to convert one gross (0.7 net) well into a salt water disposal well. Barnwell participated in the drilling of one exploratory well which was waiting to be tied in at September 30, 2012. Of the eight wells Barnwell participated in the drilling of during fiscal 2012, five gross (2.7 net) wells were on prospects developed by Barnwell.

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The following table sets forth more detailed information with respect to the number of exploratory ( Exp. ) and development ( Dev. ) wells drilled for the fiscal years ended September 30, 2012, 2011 and 2010 in which Barnwell participated. All wells were drilled in Canada.

|                    | Productive Oil Wells |            | Productive Gas Wells |      | Total Productive Wells |            | Dry Holes |            | Total Wells |            |
|--------------------|----------------------|------------|----------------------|------|------------------------|------------|-----------|------------|-------------|------------|
|                    | Exp.                 | Dev.       | Exp.                 | Dev. | Exp.                   | Dev.       | Exp.      | Dev.       | Exp.        | Dev.       |
| <b><u>2012</u></b> |                      |            |                      |      |                        |            |           |            |             |            |
| <b>Gross</b>       | <b>1.0</b>           | <b>5.0</b> | -                    | -    | <b>1.0</b>             | <b>5.0</b> | -         | <b>2.0</b> | <b>1.0</b>  | <b>7.0</b> |
| <b>Net</b>         | <b>0.5</b>           | <b>1.2</b> | -                    | -    | <b>0.5</b>             | <b>1.2</b> | -         | <b>1.3</b> | <b>0.5</b>  | <b>2.5</b> |
| <b><u>2011</u></b> |                      |            |                      |      |                        |            |           |            |             |            |
| Gross              | -                    | 9.0        | -                    | 7.0  | -                      | 16.0       | 1.0       | 1.0        | 1.0         | 17.0       |
| Net                | -                    | 2.8        | -                    | 0.6  | -                      | 3.4        | 0.5       | 0.5        | 0.5         | 3.9        |
| <b><u>2010</u></b> |                      |            |                      |      |                        |            |           |            |             |            |
| Gross              | 1.0                  | 5.0        | -                    | 16.0 | 1.0                    | 21.0       | -         | 1.0        | 1.0         | 22.0       |
| Net                | 0.5                  | 0.8        | -                    | 1.4  | 0.5                    | 2.2        | -         | 0.1        | 0.5         | 2.3        |

At September 30, 2012, Barnwell was not in the process of drilling any oil or natural gas wells.

*Productive Wells*

As of September 30, 2012, Barnwell had interests in 701 gross (85.4 net) productive wells, of which 185 gross (33.8 net) were oil wells and 516 gross (51.6 net) were natural gas wells. Eight natural gas wells and one oil well have dual or multiple completions. All wells were in Canada.

*Developed Acreage and Undeveloped Acreage*

The following table sets forth the gross and net acres of both developed and undeveloped oil and natural gas leases which we held as of September 30, 2012.

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| Location | Developed Acreage* |        | Undeveloped Acreage* |        | Total*  |        |
|----------|--------------------|--------|----------------------|--------|---------|--------|
|          | Gross              | Net    | Gross                | Net    | Gross   | Net    |
| Canada   | 232,203            | 37,565 | 160,425              | 45,804 | 392,628 | 83,369 |

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\* Developed Acreage includes the acres covered by leases upon which there are one or more producing wells. Undeveloped Acreage includes acres covered by leases upon which there are no producing wells and which are maintained by the payment of delay rentals or the commencement of drilling thereon.

Forty-seven percent of Barnwell's undeveloped acreage is not subject to expiration at September 30, 2012. The 53% of Barnwell's leasehold interests in undeveloped acreage subject to expiration expire over the next five fiscal years, if not developed, as follows: 20% expire during fiscal 2013; 2% expire during fiscal 2014; 12% expire during fiscal 2015; 40% expire during fiscal 2016; and 26% expire during fiscal 2017. There can be no assurance that Barnwell will be successful in renewing its leasehold interests in the event of expiration.

Barnwell's undeveloped acreage includes concentrations in these areas of Alberta: Dunvegan (5,760 net acres), Thornbury (5,949 net acres) and Bonanza/Balsam (2,296 net acres) and in the following area of Saskatchewan: Seagram Lakes (3,512 net acres).

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*Marketing of Oil and Natural Gas*

Barnwell sells substantially all of its oil and natural gas liquids production under short-term contracts between itself and marketers of oil. The price of oil and natural gas liquids is freely negotiated between the buyers and sellers and is largely determined by the world price for oil, which is principally denominated in U.S. dollars.

Natural gas sold by Barnwell is generally sold under both long-term and short-term contracts with prices indexed to market prices. The price of natural gas is freely negotiated between buyers and sellers and is principally determined for Barnwell by western Canadian/Midwestern U.S. prices for natural gas. In fiscal 2012 and 2011, Barnwell took virtually all of its oil, natural gas liquids, and natural gas in kind where Barnwell markets the products instead of having the operator of a producing property market the products on Barnwell's behalf.

Barnwell's oil and natural gas segment derived 67% of its oil and natural gas revenues in fiscal 2012 from three individually significant customers, Shell Trading Canada (49%), ProGas Limited (11%) and Glencoe Resources Limited (7%). Barnwell's natural gas production from Dunvegan and other properties is sold on the spot market under daily and monthly contracts in a manner consistent with current industry practice to marketers. In fiscal 2012, 12% of Barnwell's production was marketed by an agent acting on behalf of Barnwell where all products are sold directly to the final purchasers with the agent not taking title to the production.

In fiscal 2012, over 90% of Barnwell's oil and natural gas revenues were from products sold at spot prices.

*Governmental Regulation*

The jurisdictions in which the oil and natural gas properties of Barnwell are located have regulatory provisions relating to permits for the drilling of wells, the spacing of wells, the prevention of oil and natural gas waste, allowable rates of production and other matters. The amount of oil and natural gas produced is subject to control by regulatory agencies in each province that periodically assign allowable rates of production. The province of Alberta and Government of Canada also monitor and regulate the volume of natural gas that may be removed from the province and the conditions of removal.

There is no current government regulation of the price that may be charged on the sale of Canadian oil or natural gas production. Canadian natural gas production destined for export is priced by market forces subject to export contracts

meeting certain criteria prescribed by Canada's National Energy Board and the Government of Canada.

Different royalty rates are imposed by the provincial governments, the Government of Canada and private interests with respect to the production and sale of oil, natural gas and natural gas liquids. In addition, provincial governments receive additional revenue through the imposition of taxes on oil and natural gas owned by private interests within the province. Essentially, provincial royalties are calculated as a percentage of revenue and vary depending on production volumes, selling prices and the date of discovery.

Eighty-eight percent of Barnwell's gross revenues are derived from properties located within Alberta.

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The province of Alberta charges oil and natural gas producers a royalty for production in Alberta. The province of Alberta determines its royalty share of natural gas and oil by using reference prices that average all natural gas sales and oil sales, respectively, in Alberta. Barnwell also pays gross overriding royalties and leasehold royalties on a portion of its natural gas and oil sales to parties other than the province of Alberta.

On January 1, 2009, a New Royalty Framework ( NRF ) went into effect, whereby royalty rates on conventional oil and natural gas production were both price-sensitive and production-sensitive and may increase up to a maximum royalty rate of 50%. The price-sensitive maximum is reached for oil when oil is selling at or above \$120.00 Canadian dollars per barrel and for natural gas when natural gas is selling at or above \$17.50 Canadian dollars per Mcf. Effective January 1, 2011, the Government of Alberta modified Alberta's royalty framework. The modified framework reduced the maximum royalty rate of 50% for oil and natural gas production to 40% and 36%, respectively, and also introduced a new well royalty rate of 5% for both new oil and natural gas wells for up to 12 months after the start of production. In fiscal 2012, 74% of royalties related to Alberta government charges and 26% of royalties related to freehold, override and other charges which are not directly affected by the NRF. In fiscal 2011, 69% of royalties related to Alberta government charges and 31% of royalties related to freehold, override and other charges which are not directly affected by the NRF.

In November 2008, the Alberta government announced a one-time option of selecting new transitional rates or NRF rates when drilling a new natural gas or conventional oil well 1,000 to 3,500 meters in depth. All wells drilled between January 1, 2009 and December 31, 2013 that adopt the transitional rates will be shifted to the NRF on January 1, 2014. As of January 1, 2009, all of Barnwell's wells in Alberta pay royalties under the NRF and all new commercial wells drilled since January 1, 2009 adopted the transitional royalty rates.

In fiscal 2012, the weighted-average royalty rate paid on all of Barnwell's natural gas was 5%. The weighted-average rate of all royalties paid to governments and others on natural gas from the Dunvegan Unit, Barnwell's principal oil and natural gas property, was 1% in fiscal 2012.

In fiscal 2012, the weighted-average royalty rate paid on oil was 23%.

In 2009, the Alberta government announced a short-term incentive program which included a drilling royalty credit for new conventional oil and natural gas wells. Under the program, the Canadian province of Alberta provided a temporary drilling royalty credit based on a fixed dollar amount per meter drilled to eligible companies which drilled new conventional oil and natural gas wells on Alberta crown lands from April 1, 2009 to March 31, 2011. The drilling royalty credit program ended in 2011.

During fiscal 2008, the Canadian government enacted reductions in the corporate tax rate from 18.5% in calendar years 2011 and 2012 to 16.5% and 15% in calendar years 2011 and 2012, respectively. There was no enactment of a reduction in Canadian tax rates during fiscal 2011 or 2012.

### *Competition*

The majority of Barnwell's natural gas sales take place in Alberta, Canada. Natural gas prices in Alberta are generally competitive with other major North American areas due to sufficient pipeline capacity into the United States. Barnwell's oil and natural gas liquids are sold in Alberta with prices determined by the world price for oil.

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Barnwell competes in the sale of oil and natural gas on the basis of price and on the ability to deliver products. The oil and natural gas industry is intensely competitive in all phases, including the exploration for new production and reserves and the acquisition of equipment and labor necessary to conduct drilling activities. The competition comes from numerous major oil companies as well as numerous other independent operators. There is also competition between the oil and natural gas industry and other industries in supplying the energy and fuel requirements of industrial, commercial and individual consumers. Barnwell is a minor participant in the industry and competes in its oil and natural gas activities with many other companies having far greater financial, technical and other resources.

## **Land Investment Segment**

### *Overview*

Barnwell owns a 77.6% controlling interest in Kaupulehu Developments, a Hawaii general partnership that owns interests in leasehold land at Kaupulehu, located approximately six miles north of the Kona International Airport in the North Kona District of the island of Hawaii.

Kaupulehu 2007, a Hawaii limited liability limited partnership 80%-owned by Barnwell, owns two residential parcels held for investment in the Lot 4A Increment I area of Kaupulehu. See Residential Real Estate Segment for a discussion of Kaupulehu 2007's luxury residence for sale.

Barnwell, through wholly-owned Kaupulehu Mauka Investors, LLC, owns acquisition rights as to 14 lots within agricultural-zoned leasehold land in the upland area of Kaupulehu ( Mauka Lands ) situated between the Queen Kaahumanu Highway and the Mamalahoa Highway. The acquisition rights give Barnwell the right to acquire 14 residential lots, currently estimated to be two to five acres in size, which may be developed on the Mauka Lands. These lands are currently classified as agricultural by the state of Hawaii and, accordingly, the developer of these lands (Hualalai Investors) will need to pursue both state and county of Hawaii approvals for reclassification and rezoning to permit the development of residential lots and negotiate development terms.

### *Operations*

In the 1980s, Kaupulehu Developments obtained the state and county zoning changes necessary to permit development of the Four Seasons Resort Hualalai at Historic Kaupulehu and Hualalai Golf Club, which opened in

1996, a second golf course, and single-family and multi-family residential units. These projects were developed by an unaffiliated entity on leasehold land acquired from Kaupulehu Developments.

Between 1993 and 2001, Kaupulehu Developments obtained the state and county zoning changes necessary to permit development of single-family and multi-family residential units, a golf course and a limited commercial area on approximately 870 leasehold acres, zoned for resort/residential development, located adjacent to and north of the Four Seasons Resort Hualalai at Historic Kaupulehu.

In 2004 and 2006, Kaupulehu Developments transferred its leasehold interest in the aforementioned approximately 870 acres in two increments ( Increment I and Increment II ) to WB and WBKD and received closing payments of \$11,550,000 and \$10,000,000, respectively. WB and WBKD are entities not affiliated with Barnwell and its subsidiaries. WB and WBKD are affiliated with RP-Hualalai Investors, LLC, a managing member of Hualalai Investors, and Westbrook Partners, developers of Kukuia Resort located adjacent to Hualalai Resort.

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Increment I is an area planned for approximately 80 single-family lots and a beach club on the portion of the property bordering the Pacific Ocean. The lots within Increment I consist of two phases. Phase I consists of 38 completed single-family lots (23 ocean front lots and 15 ocean view lots) and Phase II is planned for 42 single-family lots. The developer recently released and began marketing a portion of the 42 single-family lots in Phase II. The Company cannot predict when WB will complete the remaining single-family lots in Phase II. The purchasers of the 80 single-family lots will have the right to apply for membership in the Kūki'o Golf and Beach Club, which is located adjacent to and south of the Four Seasons Resort Hualalai at Historic Kaupulehu. Increment II is the remaining portion of the approximately 870-acre property and is zoned for single-family and multi-family residential units and a golf course and clubhouse. Increment II is not yet developed.

Kaupulehu Developments is entitled to receive payments from WB based on the following percentages of the gross receipts from WB's sales of single-family residential lots in Increment I: 9% of the gross proceeds from single-family lot sales up to aggregate gross proceeds of \$100,000,000; 10% of such aggregate gross proceeds greater than \$100,000,000 up to \$300,000,000; and 14% of such aggregate gross proceeds in excess of \$300,000,000. In fiscal 2012, two single-family lots were sold bringing the total amount of gross proceeds from single-family lot sales through September 30, 2012 to \$150,000,000. As of September 30, 2012, 31 of the 38 single-family lots in Phase I of Increment I have been sold.

Kaupulehu Developments is entitled to receive payments from WBKD based on a percentage of the sales price of WBKD's sales of residential lots or units in Increment II ranging from 8% to 10% of the price of improved or unimproved lots or 2.60% to 3.25% of the price of units constructed on a lot, to be determined in the future depending upon a number of variables, including whether the lots are sold prior to improvement. Kaupulehu Developments is also entitled to receive up to \$8,000,000 in additional payments after the members of WBKD have received distributions equal to the capital they invested in the project.

WB and/or WBKD have the exclusive right to negotiate with Kaupulehu Developments with respect to approximately 1,000 acres of vacant leasehold land zoned conservation in the Kaupulehu area located adjacent to Increment II ( Lot 4C ) until June 2013 unless extended by Barnwell.

*Competition*

Barnwell's land investment segment is subject to intense competition in all phases of its operations including the acquisition of new properties, the securing of approvals necessary for land rezoning, and the search for potential buyers of property interests presently owned. The competition comes from numerous independent land development companies and other industries involved in land investment activities. The principal factors affecting competition are the location of the project and pricing. Barnwell is a minor participant in the land development industry and competes

in its land investment activities with many other entities having far greater financial and other resources.

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**Contract Drilling Segment**

*Overview*

Barnwell's wholly-owned subsidiary, Water Resources, drills water, water monitoring and geothermal wells of varying depths in Hawaii, installs and repairs water pumping systems, and is the state of Hawaii's distributor for Floway pumps and equipment.

*Operations*

Water Resources owns and operates one Spencer-Harris portable rotary drilling rig capable of drilling up to approximately 7,000 feet, an IDECO H-35 rotary drilling/workover rig, two GEFECO SS-40-T portable rotary drilling rigs, a National T-32 drilling rig, and other ancillary drilling equipment. Water Resources also owns and operates one Walker Neer P-15-A and one Franks double drum service rig for deep set pump removal, installations and repairs. Additionally, Water Resources leases a three-quarter of an acre maintenance facility in Honolulu, Hawaii, a one acre maintenance and storage facility with 2,800 square feet of interior space in Kawaihae, Hawaii, and a one acre equipment storage yard in Waimea, Hawaii, and maintains an inventory of drilling materials and pump supplies.

Water Resources currently operates in Hawaii and is not subject to seasonal fluctuations. The demand for Water Resources' services is primarily dependent upon land development activities in Hawaii. Water Resources markets its services to land developers and government agencies, and identifies potential contracts through public notices, its officers' involvement in community activities and referrals. Contracts are usually fixed price per lineal foot drilled or day rate contracts and are negotiated with private entities or obtained through competitive bidding with private entities or local, state and federal agencies. Contract revenues are not dependent upon the discovery of water, geothermal production zones or other similar targets, and contracts are not subject to renegotiation of profits or termination at the election of the governmental entities involved. Contracts provide for arbitration in the event of disputes.

Water Resources derived 12% and 53% of its contract drilling revenues in fiscal 2012 and 2011, respectively, pursuant to federal, state of Hawaii and county contracts. At September 30, 2012, Water Resources had accounts receivables from federal, state of Hawaii and county entities totaling \$150,000. Water Resources has lien rights on wells drilled and pumps installed for federal, state of Hawaii, county and private entities.

In fiscal 2012, Water Resources started two well drilling and eight pump installation and repair contracts and completed twelve pump installation and repair contracts. Six of the twelve pump installation and repair contracts were started in the prior year. Fifty-eight percent of well drilling and pump installation and repair jobs, representing 12% of total contract drilling revenues in fiscal 2012, have been pursuant to government contracts.

At September 30, 2012, Water Resources had a backlog of three well drilling and eight pump installation and repair contracts, of which two well drilling and four pump installation and repair contracts were in progress as of September 30, 2012.

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The dollar amount of Water Resources' backlog of firm well drilling and pump installation and repair contracts at December 1, 2012 and 2011 was as follows:

|                              | December 1,  |            |
|------------------------------|--------------|------------|
|                              | 2012         | 2011       |
| Well drilling                | \$ 400,000   | \$ -       |
| Pump installation and repair | 920,000      | 570,000    |
|                              | \$ 1,320,000 | \$ 570,000 |

All of the contracts in backlog at December 1, 2012 are expected to be completed within fiscal year 2013.

*Competition*

Water Resources competes with other drilling contractors in Hawaii, some of which use drill rigs similar to Water Resources' drilling rigs. These competitors are also capable of installing and repairing vertical turbine and submersible water pumping systems in Hawaii. These contractors compete actively with Water Resources for government and private contracts. Pricing is Water Resources' major method of competition; reliability of service is also a significant factor.

Competitive pressures are expected to remain high, thus there is no assurance that the quantity of available or awarded jobs which occurred in fiscal 2012 will continue.

**Residential Real Estate Segment**

*Overview*

Kaupulehu 2007 develops luxury residences for sale.

*Operations*

We began our homebuilding business in fiscal 2007 when Kaupulehu 2007 purchased two parcels in the Lot 4A Increment I area of Kaupulehu from WB. Construction of the two homes commenced in fiscal 2007 and was completed in fiscal 2009. During fiscal 2012, one of the homes developed by Kaupulehu 2007 was sold. At September 30, 2012, Kaupulehu 2007 owns one luxury residence that is available for sale and did not have any homes under construction. This home is a 5-bedroom, 6.5-bath ranch-style home and is 6,275 square feet in size. Construction of additional homes will depend upon the timing and extent of changes in market conditions and the ability of the Company to obtain financing for such projects.

### *Competition*

Barnwell's residential real estate segment is subject to intense competition in all phases of its operations including the acquisition of land, the building of residential homes, including the need for raw materials and skilled labor, and the search for potential purchasers of completed homes. The competition comes from numerous independent real estate developers. The principal factors affecting competition are the location of the project, reputation, design, quality and pricing. Kaupulehu 2007 is a newcomer and a minor participant in the residential real estate industry and competes with many other entities having far greater financial and other resources.

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**Financial Information About Industry Segments and Geographic Areas**

Note 12 in the Notes to Consolidated Financial Statements in Item 8 contains information on our segments and geographic areas.

**Employees**

As of December 1, 2012, Barnwell employed 37 individuals; 35 on a full time basis and 2 on a part time basis.

**Environmental Costs**

Barnwell is subject to extensive environmental laws and regulations. Federal, state, and Canadian governmental agencies issue rules and regulations and enforce laws to protect the environment which are often difficult and costly to comply with and which carry substantial penalties for failure to comply, particularly in regard to the discharge of materials into the environment. These laws, which are constantly changing, regulate the discharge of materials into the environment and maintenance of surface conditions and may require Barnwell to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites. Barnwell did not incur material environmental costs in fiscal 2012.

**Available Information**

We are required to file annual, quarterly and current reports and other information with the SEC. These filings are not deemed to be incorporated by reference in this report. You may read and copy any document filed by us at the Public Reference Room of the SEC, 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Our filings with the SEC are also available to the public through the SEC's website at [www.sec.gov](http://www.sec.gov). Furthermore, we maintain an internet site at [www.brninc.com](http://www.brninc.com). We make available on our internet website free of charge our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as practicable after we electronically file such reports with, or furnish them to, the SEC. The contents of these websites are not incorporated into this filing. Furthermore, the Company's references to URLs for these websites are intended to be textual references only.

**ITEM 1A. RISK FACTORS**

The business of Barnwell and its subsidiaries face numerous risks, including those set forth below or those described elsewhere in this Form 10-K or in Barnwell's other filings with the SEC. The risks described below are not the only risks that Barnwell faces, nor are they necessarily listed in order of significance. If any of the following risk factors should occur, our profitability, financial condition or liquidity could be materially impacted.

*Entity-Wide Risks*

**The continued economic slowdown and depressed prices for natural gas may have impacts on our business and financial condition that we currently cannot predict.**

The economic slowdown has affected demand for oil and natural gas, luxury real estate, and water well drilling and pump installation services. Additionally, the discovery and availability of natural gas from shale has resulted in an oversupply of natural gas in North America. Absent a sufficient increase in natural gas and/or oil prices, it is unlikely that future oil and natural gas operating cash flows will be sufficient to fund the capital expenditure levels necessary to maintain current production and reserve levels.

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If Barnwell's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on terms acceptable to the Company. Inability to access sufficient capital and credit, in combination with insufficient operating cash flows and land investment sales proceeds, will result in continuing decreases in oil and natural gas reserves that in turn will result in a decline in cash flows from oil and natural gas production to amounts that are insufficient to cover ongoing expenses and debt service requirements.

**Our future level of indebtedness and the terms of our financing arrangements may adversely affect our operations, financial condition and limit our growth.**

At September 30, 2012, we had borrowings under our credit facility and real estate loan of approximately \$17.2 million. In the ordinary course of business, we may incur significant additional debt in order to fund future capital expenditures, acquisitions and homebuilding activities.

The terms of our credit facility and real estate loan impose restrictions on our ability and, in some cases, the ability of our subsidiaries to take a number of actions that we may otherwise desire to take, including one or more of the following:

- incurring additional debt, including guarantees of indebtedness;
- making investments;
- creating liens on our assets; and
- selling assets.

Our level of indebtedness and the covenants contained in our financing agreements could have important consequences. For example, they could:

- limit our ability to obtain future financing, through equity offerings or debt financings, for working capital, capital expenditures, acquisitions, refinancing of indebtedness or general corporate and other activities;
- require us to dedicate a substantial portion of our cash flow from operations to service our debt, thereby reducing our ability to use our cash flow for other purposes (i.e., working capital, capital expenditures, and other

general business activities);

- limit our flexibility in planning for, or reacting to, the changes in our business;
- subject us to higher costs and more restrictive covenants in the future for working capital, capital expenditures, acquisitions, general corporate or other purposes, if additional financing is obtained;
- make us vulnerable to increases in interest rates as our credit facilities are subject to variable interest rates;
- detract from our ability to successfully withstand a downturn in our business or the economy generally;
- place us at a competitive disadvantage because we have more debt than some of our competitors; and
- make us more vulnerable to general economic downturns and adverse developments in our industries, especially declines in oil and natural gas prices, and the economy in general.

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We may incur additional debt, including significant secured indebtedness, or issue additional stock in order to fund capital expenditures, make future acquisitions, and develop our properties. A higher level of indebtedness increases the risk that we may default on our obligations. Our ability to meet our debt obligations and to reduce our level of indebtedness depends on our future performance. General economic conditions, oil and natural gas prices and financial, business and other factors affect our operations and our future performance. Many of these factors are beyond our control. Factors that will affect our ability to raise cash through a refinancing of our debt include financial market conditions, the value of our assets and our performance at the time we need capital.

In addition, our Canadian revolving credit facility is subject to periodic redetermination. A decrease in the facility could require us to repay indebtedness in excess of the borrowing base, or we may need to further secure the lenders with additional collateral. Furthermore, our real estate loan agreement contains provisions requiring us to maintain compliance with a consolidated debt service coverage ratio of not less than 1.20 to 1 and a consolidated total liabilities to tangible net worth ratio not to exceed 1.85 to 1. Noncompliance with any of the ratios could result in the need to pay down a portion of the outstanding borrowings before their scheduled due dates.

**The price of our common stock has been volatile and could continue to fluctuate substantially.**

The market price of our common stock has been volatile and could fluctuate based on a variety of factors, including:

- fluctuations in commodity prices;
- variations in results of operations;
- announcements by us and our competitors;
- legislative or regulatory changes;
- general trends in the industry;
- general market conditions; and
- analysts' estimates and other events in the oil and natural gas industry.

**Failure to retain key personnel could hurt our operations.**

We require highly skilled and experienced personnel to operate our business. In addition to competing in highly competitive industries, we compete in a highly competitive labor market. Our business could be adversely affected by an inability to retain personnel or upward pressure on wages as a result of the highly competitive labor market.

**A small number of stockholders, including our executive officers, own a significant amount of our common stock and have influence over our business regardless of the opposition of other stockholders.**

As of September 30, 2012, four of our stockholders, including two of our executive officers, held approximately 44% of our outstanding common stock. The interests of one or more of these stockholders may not always coincide with the interests of other stockholders. These stockholders have significant influence over all matters submitted to our stockholders, including the election of our directors, and could accelerate, delay, deter or prevent a change of control of the Company. The significant stockholders who also are executive officers could significantly affect our business, policies and affairs.

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**Adverse changes in actuarial assumptions used to calculate retirement plan costs due to economic or other factors, or lower returns on plan assets could adversely affect Barnwell's results and financial condition.**

Retirement plan cash funding obligations and plan expenses and obligations are subject to a high degree of uncertainty and could increase in future years depending on numerous factors, including the performance of the financial markets, specifically the equity markets, and the levels of interest rates.

**We are involved as a passive minority-interest partner in joint ventures and are subject to risks associated with joint venture partnerships.**

We are involved as a passive minority-interest partner in joint venture relationships and may initiate future joint venture projects. Entering into a joint venture as a passive minority-interest partner involves certain risks which include:

- the inability to exercise voting control over the joint venture;
- economic or business interests which are not aligned with our venture partners, including the holding period and timing of ultimate sale of the ventures' underlying assets; and
- the inability for the venture partner to fulfill its commitments and obligations due to financial or other difficulties.

*Risks Related to Oil and Natural Gas Segment*

**The oil and natural gas industry is highly competitive.**

We compete for capital, acquisitions of reserves, undeveloped lands, skilled personnel, access to drilling rigs, service rigs and other equipment, access to processing facilities, pipeline capacity and in many other respects with a substantial number of other organizations, many of which may have greater technical and financial resources than we do. Some of these organizations explore for, develop and produce oil and natural gas, carry on refining operations and market oil and other products on a worldwide basis. As a result of these complementary activities, some of our competitors may have competitive resources that are greater and more diverse than ours. Furthermore, many of our

competitors may have a competitive advantage when responding to factors that affect demand for oil and natural gas production, such as changing prices and production levels, the cost and availability of alternative fuels and the application of government regulations. If our competitors are able to capitalize on these competitive resources, it could adversely affect our revenues.

**Oil and natural gas prices are volatile. Our results of operations and financial condition are highly dependent on the prices of and demand for our oil and natural gas production.**

Oil and natural gas prices are volatile and have fluctuated widely during recent years in response to many factors that are beyond our control. These factors include, but are not limited to, changes in supply and demand, market uncertainty, weather, worldwide political instability, foreign supply of oil and natural gas, the level of consumer product demand, government regulations and taxes, the price and availability of alternative fuels and the overall economic environment. Any decline in oil or natural gas prices may have a material adverse effect on our operations, financial condition, operating cash flows, borrowing ability, reserves, and the amount of capital that we are able to allocate for the development of oil and natural gas reserves and future growth.

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Energy prices are also subject to other political and regulatory actions outside our control, which may include changes in the policies of the Organization of Petroleum Exporting Countries or other developments involving or affecting oil-producing countries, or actions or reactions of the government of the United States in anticipation of or in response to such developments.

**If oil and natural gas prices decrease, we may be required to reduce the carrying value of our oil and natural gas properties.**

We follow the full cost method of accounting for costs related to our oil and natural gas properties. Under this method, the net book value of properties less related deferred income taxes, may not exceed a calculated ceiling. The ceiling is the estimated after tax future net revenues from proved oil and natural gas properties, discounted at 10% per year. In calculating discounted future net revenues, average first-day-of-the-month oil and natural gas prices during the 12-month period ending in the reporting period are held constant, except for changes which are fixed and determinable by existing contracts. The excess, if any, of the net book value above the ceiling is required to be written off as an expense. A sufficient decline in oil or natural gas prices or other factors, without other mitigating circumstances, could result in future reductions of the carrying value of our oil and natural gas properties and an equivalent charge to earnings.

**An increase in operating costs or a decline in our production level could have a material adverse effect on our results of operations and financial condition.**

Higher operating costs for our properties will directly decrease the amount of cash flow received by us. Electricity, supplies, and labor costs are a few of the operating costs that are susceptible to material fluctuation. The need for significant repairs and maintenance of infrastructure may increase as our properties age. A significant increase in operating costs could result in materially lower operating margin and cash flow.

The level of production from our existing properties may decline at rates greater than anticipated due to unforeseen circumstances, many of which are beyond our control. A significant decline in our production could result in materially lower revenues and cash flow.

**Our operating results are affected by our ability to market the oil and natural gas that we produce.**

Our business depends in part upon the availability, proximity and capacity of natural gas gathering systems, pipelines and processing facilities. Canadian federal and provincial, as well as United States federal and state, regulation of oil and natural gas production, processing and transportation, tax and energy policies, general economic conditions, and changes in supply and demand could adversely affect our ability to produce and market oil and natural gas. If market factors change and inhibit the marketing of our production, overall production or realized prices may decline.

**We are not the operator and have limited influence over the operations of the majority of our oil and natural gas properties.**

We hold minority interests in the majority of our oil and natural gas properties. As a result, we cannot control the pace of exploration or development, major decisions affecting the drilling of wells or the plan for development and production at non-operated properties, although contract provisions

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give Barnwell certain consent rights in some matters. The operator's influence over these matters can affect the pace at which we incur capital expenditures. Additionally, as certain underlying joint venture data is not accessible to us, we depend on the operators at non-operated properties to provide us with reliable accounting information.

**Our operations are subject to domestic and foreign government regulation and other risks, particularly in Canada and the United States.**

Barnwell's oil and natural gas operations are affected by political developments and laws and regulations, particularly in Canada and the United States, such as restrictions on production, restrictions on imports and exports, the maintenance of specified reserves, tax increases and retroactive tax claims, expropriation of property, cancellation of contract rights, environmental protection controls, environmental compliance requirements and laws pertaining to workers' health and safety. Further, the right to explore for and develop oil and natural gas on lands in Alberta, Saskatchewan and British Columbia is controlled by the governments of each of those provinces. Changes in royalties and other terms of provincial leases, permits and reservations may have a substantial effect on Barnwell's operations. We derive a significant portion of our revenues from our operations in Canada. In fiscal 2012, we derived 74% of our revenues from operations in Canada.

Additionally, our ability to compete in the Canadian oil and natural gas industry may be adversely affected by governmental regulations or other policies that favor the awarding of contracts to contractors in which Canadian nationals have substantial ownership interests. Furthermore, we may face governmentally imposed restrictions or fees from time to time on the transfer of funds to the U.S.

Government regulations control and often limit access to potential markets and impose extensive requirements concerning employee safety, environmental protection, pollution control and remediation of environmental contamination. Environmental regulations, in particular, prohibit access to some markets and make others less economical, increase equipment and personnel costs and often impose liability without regard to negligence or fault. In addition, governmental regulations may discourage our customers' activities, reducing demand for our products and services.

**Compliance with foreign tax and other laws may adversely affect our operations.**

Tax and other laws and regulations are not always interpreted consistently among local, regional and national authorities. Income tax laws, other legislation or government incentive programs relating to the oil and natural gas industry may in the future be changed or interpreted in a manner that adversely affects us and our stockholders. It is

also possible that in the future we will be subject to disputes concerning taxation and other matters in Canada, including the manner in which we calculate our income for tax purposes, and these disputes could have a material adverse effect on our financial performance.

**We are dependent upon future discoveries or acquisitions of oil and natural gas to maintain our reserves.**

We actively explore for oil and natural gas reserves. However, future exploration and drilling results are uncertain and may involve substantial costs. Despite this uncertainty or potential cost, discoveries or acquisitions of additional reserves are needed to avoid a material decline in reserves and production. As a result, future oil and natural gas reserves may be dependent on our success in exploiting existing properties and acquiring additional reserves. If our access to capital becomes limited or unavailable, our ability to make the necessary capital investments to maintain or expand our

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oil and natural gas reserves will be impaired. Additionally, we cannot guarantee that we will be successful in developing additional reserves or acquiring additional reserves on terms that meet our investment objectives. Without these reserve additions, our reserves will deplete and as a consequence, either production from, or the average reserve life of, our properties will decline.

**Actual reserves will vary from reserve estimates.**

Estimating reserves is inherently uncertain and the reserves estimation process involves significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data. The reserve data and standardized measures set forth herein are only estimates. Ultimately, actual reserves attributable to our properties will vary from estimates, and those variations may be material. The estimation of reserves involves a number of factors and assumptions, including, among others:

- oil and natural gas prices as prescribed by the SEC;
- historical production from our wells compared with production rates from similar producing wells in the area;
- future commodity prices, production and development costs, royalties and capital expenditures;
- initial production rates;
- production decline rates;
- ultimate recovery of reserves;
- success of future development activities;
- marketability of production;
- effects of government regulation; and
- other government levies that may be imposed over the producing life of reserves.

If these factors, assumptions and prices prove to be inaccurate, actual results may vary materially from reserve estimates.

**Delays in business operations could adversely affect our distributions.**

In addition to the usual delays in payment by purchasers of oil and natural gas to the operators of our properties, and the delays of those operators in remitting payment to us, payments between any of these parties may also be delayed by:

- restrictions imposed by lenders;
- accounting delays;
- delays in the sale or delivery of products;
- delays in the connection of wells to a gathering system;
- blowouts or other accidents;
- adjustments for prior periods;
- recovery by the operator of expenses incurred in the operation of the properties; and
- the establishment by the operator of reserves for these expenses.

Any of these delays could expose us to additional third party credit risks.

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**The industry in which we operate exposes us to potential liabilities that may not be covered by insurance.**

Our operations are subject to all of the risks associated with the operation and development of oil and natural gas properties, including the drilling of oil and natural gas wells, and the production and transportation of oil and natural gas. These risks include encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, equipment failures and other accidents, cratering, sour gas releases, uncontrollable flows of oil, natural gas or well fluids, adverse weather conditions, pollution, other environmental risks, fires and spills. A number of these risks could result in personal injury, loss of life, or environmental and other damage to our property or the property of others.

While we maintain reserves for anticipated liabilities and carry various levels of insurance, we could be affected by civil, criminal, regulatory or administrative actions, claims or proceedings. We cannot fully protect against all of the risks listed above, nor are all of these risks insurable. There is no assurance that any applicable insurance or indemnification agreements will adequately protect us against liability for the risks listed above. We could face substantial losses if an event occurs for which we are not fully insured or are not indemnified against or a customer or insurer fails to meet its indemnification or insurance obligations. In addition, there can be no assurance that insurance will continue to be available to cover any or all of these risks, or, even if available, that insurance premiums or other costs will not rise significantly in the future, so as to make the cost of such insurance prohibitive.

**We may incur material costs to comply with or as a result of health, safety, and environmental laws and regulations.**

The oil and natural gas industry is subject to extensive environmental regulation pursuant to local, provincial and federal legislation. A violation of that legislation may result in the imposition of fines or the issuance of clean up orders. Legislation regulating the oil and natural gas industry may be changed to impose higher standards and potentially more costly obligations. Although we have recorded a provision in our financial statements relating to our estimated future environmental and reclamation obligations that we believe is reasonable, we cannot guarantee that we will be able to satisfy our actual future environmental and reclamation obligations.

We are not fully insured against certain environmental risks, either because such insurance is not available or because of high premium costs. In particular, insurance against risks from environmental pollution occurring over time, as opposed to sudden and catastrophic damages, is not available on economically reasonable terms. Accordingly, any site reclamation or abandonment costs actually incurred in the ordinary course of business in a specific period could negatively impact our cash flow. Should we be unable to fully fund the cost of remedying an environmental problem, we might be required to suspend operations or enter into interim compliance measures pending completion of the required remedy.

**We may have difficulty funding our planned capital expenditures, which could have an adverse effect on our business.**

We make and expect to continue to make capital expenditures in our exploration and development projects. Without adequate capital resources, our drilling and other activities may be limited and our business, financial condition and results of operations may suffer. We may not be able to generate sufficient operating cash flows or secure necessary financing on reasonable terms or at all

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and financing may not continue to be available to us under our existing financing arrangements. If capital resources are unavailable, we may be forced to curtail our drilling, development and other activities or be forced to sell some of our assets under untimely or unfavorable terms. Any such curtailment or sale could have a material adverse effect on our business, financial condition and results of operations.

**Unforeseen title defects may result in a loss of entitlement to production and reserves.**

Although we conduct title reviews in accordance with industry practice prior to any purchase of resource assets or property, such reviews do not guarantee that an unforeseen defect in the chain of title will not arise and defeat our title to the purchased assets. If such a defect were to occur, our entitlement to the production from such purchased assets could be jeopardized.

*Risks Related to Land Investment Segment*

**The real estate investment industry continues to experience a slowdown that may persist for an indefinite period. This downturn in economic conditions could adversely affect our business, results of operations and stockholders' equity.**

The real estate investment industry is cyclical in nature and is particularly vulnerable to shifts in local, regional, and national economic conditions outside of our control such as interest rates, housing demand, population growth, employment levels, job growth and property taxes. Further, a weakening of the economic drivers in Hawaii, which include tourism, military spending, construction starts and employment, and a decrease in market demand adversely impacted the level of real estate activity in Hawaii. The industry has experienced a significant decrease in demand for new luxury resort real estate since 2007 and this trend may continue for an extended period of time. Conditions in both the United States and international economies remain weak, which puts continued pressure on consumer confidence for residential real estate. These challenging market conditions are expected to continue for the foreseeable future and, in the near term, these conditions may further deteriorate. We expect that continued weakness in the industry could adversely affect our business, results of operations and financial condition.

Considerable economic and political uncertainties currently exist that could have adverse effects on consumer buying habits, construction costs, availability of labor and materials and other factors affecting us and the real estate industry in general. Significant expenditures associated with investment in real estate, such as real estate taxes, insurance, maintenance costs and debt payments, cannot generally be reduced even though changes in Hawaii's or the nation's economy may cause a decrease in revenues from our properties.

**Our real estate business is concentrated in the state of Hawaii. As a result, our financial results are dependent on the economic growth and health of Hawaii, particularly the island of Hawaii.**

Barnwell's land investment segment is impacted by the condition of Hawaii's real estate market, which is affected by Hawaii's economy and Hawaii's tourism industry, as well as the United States and world economies in general. Any future cash flows from Barnwell's land development activities are subject to, among other factors, the level of real estate activity and prices, the demand for new housing and second homes on the island of Hawaii, the rate of increase in the cost of building materials and labor, the introduction of building code modifications, changes to zoning laws, and the level of confidence in Hawaii's economy.

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**The occurrence of natural disasters in Hawaii could adversely affect our business.**

The occurrence of a natural disaster in Hawaii such as, but not limited to, earthquakes, landslides, hurricanes, tornadoes, tsunamis, volcanic activity, droughts and floods, could have a material adverse effect on our ability to develop and sell properties or realize income from our projects. The occurrence of a natural disaster could also cause property and flood insurance rates and deductibles to increase, which could reduce demand for our properties.

**Increases in interest rates, tightening of lending standards and decreases, limitations or restrictions in the availability of mortgage financing and other economic factors outside our control, such as consumer confidence and declines in employment levels could lead to slowed home sales, which could adversely affect our revenues and earnings.**

The United States residential mortgage market continues to experience disruption. Mortgage interest rates have been experiencing significant volatility and contributed to the challenging market conditions faced by us and the industry. In addition, as a result of increased default rates and other factors, the willingness of many lenders to make home mortgage loans has decreased and lenders have tightened their lending standards. The volatility in interest rates, the decrease in the willingness of lenders to make home mortgage loans, and the tightening of lending standards have made it more difficult for some potential buyers to finance the purchase of homes. Potential buyers may not be able to obtain acceptable financing to purchase residential lots within the Kaupulehu area, leading to further declines in the market for homes. Any limitations or restrictions on the availability of mortgage financing or increases in mortgage interest rates could reduce residential lot sales, thereby reducing our revenues and earnings. Even if potential buyers do not need financing, changes in interest rates and mortgage availability could make it harder for them to sell their existing homes to potential buyers who need financing. Any limitations or restrictions on the availability of mortgage financing or interest rate increases could adversely affect our sales, which would reduce our revenues.

**Our business is subject to extensive regulation which makes it difficult and expensive for us to conduct our operations.**

We are subject to a wide variety of federal, state and local laws and regulations relating to land use and development and to environmental compliance and permitting obligations, including those related to the use, storage, discharge, emission, and disposal of hazardous materials. In most cases, approval to develop requires multiple permits which involve a long, uncertain and costly regulatory process. Any failure to comply with these laws could result in capital or operating expenditures or the imposition of severe penalties or restrictions on operations that could adversely affect present and future operations, or jeopardize our ability to sell the leasehold interest currently held.

**Receipt of future percentage of sales payments is dependent upon the developer's continued efforts to develop and market the property.**

We are entitled to receive future payments based on a percentage of the sales prices of residential homes and lots within approximately 870 acres in the Kaupulehu area. However, in order to collect such percentage of sales payments we are reliant upon an unaffiliated third party developer to continue to develop and market the homes and lots. The receipt of future percentage of sales payments could be jeopardized if the developer fails to proceed with development and marketing of the property.

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**If required land use entitlements are not obtained at reasonable costs, or at all, our operating results could be adversely affected.**

We hold the leasehold interest to approximately 1,000 acres of vacant land that is currently zoned conservation. Our success in selling this interest may be contingent upon obtaining the necessary reclassification from the State of Hawaii Land Use Commission and county of Hawaii. Obtaining the necessary reclassification and ministerial approvals is often difficult, costly and may take several years, or more, to complete. Delays or failures to obtain the necessary reclassification approvals may adversely affect our financial results.

**The market value of our real estate interests could decline, which may require write-downs of the carrying value of our residential lots held for investment to its estimated fair value. Any write-downs would negatively impact our results of operations.**

The risk of owning undeveloped lots can be substantial, and we may have bought lots which we cannot profitably sell. The market value of residential lots can fluctuate significantly as a result of changing economic market conditions. Prevailing market conditions may significantly influence the market value of our residential parcels held for investment. In the event of changes in economic or market conditions, we may have to sell the residential lots at lower margins or at a loss. Furthermore, if market conditions continue to deteriorate, we may be required to write-down the carrying value of our residential parcels held for investment. Such write-downs would have a negative impact on our results of operations and financial condition.

*Risks Related to Contract Drilling Segment*

**Demand for water well drilling and/or pump installation is volatile. A decrease in demand for our services could adversely affect our revenues and results of operations.**

Demand for services is highly dependent upon land development activities in the state of Hawaii. As also noted above, the real estate development industry is cyclical in nature and is particularly vulnerable to shifts in local, regional, and national economic conditions outside of our control such as interest rates, housing demand, population growth, employment levels and job growth and property taxes. A decrease in water well drilling and/or pump installation contracts will result in decreased revenues and operating results.

**A significant portion of our contract drilling business is dependent on municipalities and a decline in municipal spending could adversely impact our business.**

A significant portion of our contract drilling division revenues is derived from water and infrastructure contracts with governmental entities or agencies. Reduced tax revenues and governmental budgets may limit spending by local governments which in turn will affect the demand for our services. Material reductions in spending by a significant number of local governmental agencies could have a material adverse effect on our business, results of operations, liquidity and financial position.

**Our contract drilling operations face significant competition.**

We face competition for our services from a variety of competitors. Many of our competitors utilize drilling rigs that drill as quickly as our equipment but require less labor. Our strategy is to compete based on pricing and to a lesser degree, quality of service. If we are unable to compete effectively with our competitors, our financial results could be adversely affected.

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**The loss of or damage to key vendor, customer or sub-contractor relationships would adversely affect our operations.**

Our contract drilling business is dependent on our relationships with key vendors, customers and subcontractors. The loss of or damage to any of our key relationships could negatively affect our business.

**Awarding of contracts is dependent upon our ability to obtain contract bid and performance bonds from insurers.**

Although the Company has not experienced difficulties in obtaining such bonds in the past, there can be no assurance that our ability to obtain such bonds will continue on the same basis as the past. Additionally, bonding insurance rates may increase and have an impact on our ability to win competitive bids, which could have a corresponding material impact on contract drilling operating results.

**The contracts in our backlog are subject to change orders and cancellation.**

Our backlog consists of the uncompleted portion of services to be performed under contracts that have been started and new contracts not yet started. Our contracts are subject to change orders and cancellations, and such changes could adversely affect our operations.

**The occurrence of natural disasters in Hawaii could adversely affect our business.**

The occurrence of a natural disaster in Hawaii such as, but not limited to, earthquakes, landslides, hurricanes, tornadoes, volcanic activity, droughts and floods, could have a material adverse effect on our ability to complete our contracts.

*Risks Related to Residential Real Estate Segment*

**The market value of our real estate interests could decline, which may require write-downs of the carrying value of our real estate held for sale to its estimated fair value. Any write-downs would negatively impact our results of operations.**

The risk of owning developed and undeveloped land can be substantial for homebuilders. Homebuilding requires that we acquire land for replacement and expansion of land inventory within our existing and new markets. The risks inherent in purchasing and developing land increase as consumer demand for housing decreases. Thus, we may have bought and developed land which we cannot profitably sell or on which we cannot profitably build and sell homes. The market value of land, buildable lots and housing inventories can fluctuate significantly as a result of changing economic market conditions. It is possible that the measures we employ to manage inventory risks will not be successful and as a result our operations may suffer. In addition, inventory carrying costs can be significant and can result in losses in a poorly performing market. Prevailing market conditions may significantly influence the market value of our real estate held for sale. In the event of changes in economic or market conditions, we may have to sell homes or land inventory at lower margins or at a loss. Furthermore, if the market conditions continue to deteriorate, we will be required to write-down the carrying value of our real estate held for sale. Such write-downs would have a negative impact on our results of operations and financial condition.

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**The homebuilding industry continues to experience a slowdown that may persist for an indefinite period. This downturn in economic conditions could adversely affect our business, results of operations and stockholders equity.**

The homebuilding industry historically has been cyclical and is sensitive to changes in economic conditions such as employment levels, consumer confidence, consumer income, availability of financing and interest rate levels. Adverse changes in any of these conditions generally, or in the market in which we operate, could decrease demand and pricing for new homes or result in customer cancellations of pending contracts, which could adversely affect the number of home deliveries we make or reduce the prices we can charge for homes, either of which could result in a reduction in our revenues or deterioration of our margins.

The homebuilding industry has experienced a significant and sustained downturn characterized by decreased demand for new homes, an oversupply of both new and resale home inventories, including foreclosed homes; aggressive price competition among homebuilders, including increased incentives for home sales; and a more restrictive mortgage lending environment. Economic conditions in the United States and the world remain weak, which puts continued pressure on consumer confidence for residential real estate. These challenging market conditions are expected to continue for the foreseeable future and, in the near term, these conditions may further deteriorate. Continued weakness in the homebuilding industry could further adversely affect our business, results of operations and financial condition.

**We are reliant upon the sale of our home as a source of liquidity. If we are unable to sell the home within a reasonable timeframe, operating results, cash inflows and financial condition could be materially impacted.**

Barnwell currently owns one luxury residence that is available for sale in the Lot 4A Increment I area of Kaupulehu, North Kona, Hawaii.

Monthly payments of principal and interest on the related real estate loan are due on the first day of each month and will change as a result of a change in the interest rate, the sale of the house or the sale of a residential parcel. Upon the sale of the house or a residential parcel, we will be required to make a principal payment in the amount of the net sales proceeds of the house or residential parcel. Any unpaid principal balance and accrued interest will be due and payable on April 1, 2018.

The timing and amount of residential home sales are unpredictable and may be sporadic. The inability to sell the home within a reasonable timeframe will lead to additional interest, maintenance, property taxes and other holding

costs. Furthermore, if estimated cash inflows from the home sale is less than current expectations, operating results, cash inflows and financial condition could be materially impacted.

**We have limited experience in the homebuilding industry.**

Homebuilding is a relatively new business segment for us, and we are relying to a material extent on our business partners to help us execute our real estate business plan.

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**We may need financing to fund our future real estate development activities. If we are unable to obtain sufficient financing or such financing is obtained on adverse terms, we may not be able to operate our business as planned, which could adversely affect our results of operations and future growth.**

The real estate development industry is capital intensive and homebuilding requires significant up-front expenditures to acquire land and begin development. We will need to establish funding sources to finance any future land acquisition capital expenditures. If such sources are not sufficient, we would seek additional capital in the form of debt or equity financing from a variety of potential sources, including additional bank financing, joint venture partner financing, and/or securities offerings. The amount and types of indebtedness which we may incur are limited by the terms of the agreements governing our existing debt. In addition, the availability of borrowed funds to be utilized for land acquisition, development and construction may be greatly reduced, and the lending community may require increased amounts of equity to be invested in a project by borrowers in connection with both new loans and the extension of existing loans. The failure to obtain sufficient capital to fund our planned capital and other expenditures could have a material adverse effect on our business.

**Our operating results from homebuilding are expected to be variable.**

Due to the cyclical nature of the real estate development industry, we expect to experience variability in our future operating results on a quarterly and an annual basis. Factors expected to contribute to this variability include, among other things:

- the timing of land acquisitions and permitting;
- the timing of home closings, land sales and level of home sales;
- our ability to continue to acquire additional land or options thereon on acceptable terms; and
- the condition of the real estate market and the general economy.

For example, the timing of land acquisitions and permitting impacts our ability to pursue the development of new housing projects in accordance with our real estate business plan. If the timing of land acquisitions, zoning or regulatory approvals is delayed, we will be delayed in our ability to develop housing projects, which would likely decrease our backlog. Furthermore, these delays could result in a decrease in our revenues and earnings for the periods in which the delays occur and possibly subsequent periods until the planned housing projects can be completed. A delay in home closings due to natural disasters, adverse weather or contractor availability would have a similar impact on revenues and earnings for the period in which the delays occur. Further, revenues may increase in

subsequent periods over what would normally be expected as a result of increased home closings as the delays described above are resolved.

**Changes in the government regulations applicable to homebuilders could restrict our business activities, increase our operating expenses and cause our revenues to decline.**

Regulatory requirements applicable to homebuilders could cause us to incur significant liabilities and operating expenses and could restrict our business activities. We are subject to local, state and federal statutes and rules regulating, among other things, certain developmental matters, building and site design, and matters concerning the protection of worker health and safety, and the environment. Our operating expenses may be increased by governmental regulations, such as building permit allocation ordinances, impact and other fees and taxes, which may be imposed to defray the cost

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of providing certain governmental services and improvements. Other governmental regulations, such as building moratoriums and no growth or slow growth initiatives, which may be adopted in communities which have developed rapidly, may cause delays in our home projects or otherwise restrict our business activities resulting in reductions in our revenues. Any delay or refusal to grant us necessary licenses, permits or approvals from government agencies could cause substantial increases to development costs or cause us to abandon the project and to sell the affected land at a potential loss, which in turn could harm our operating results.

**Our residential real estate segment is dependent on the continued availability and satisfactory performance of our building contractors, which, if unavailable, could have a material adverse effect on our business.**

We conduct our construction operations through unaffiliated building contractors. As a consequence, we depend on the continued availability of and satisfactory performance by the contractors for the construction of our homes. There may not be sufficient availability of and satisfactory performance by the contractors. If the contractors' quality of work is not sufficient, our ability to construct homes on the schedule we have planned would be affected. This could result in an increase in our costs to construct homes in a timely manner, which could result in an increase in our overall costs and thus a decline in our margins and in our net income. Further, non-timely completion of work could affect our ability to sell homes based upon our projected timeline thus possibly affecting our ability to obtain additional financing to continue our homebuilding efforts.

**Shortages of labor or materials and/or increases in the price of materials could delay construction or increase the cost of home construction thereby reducing our sales and earnings.**

The homebuilding business has from time to time experienced building material and labor shortages, as well as volatility in the prices of certain materials, including lumber, framing, drywall and cement, which are significant components of home construction costs. These labor and material shortages can be more severe during periods of strong demand for housing or during periods where the area in which we operate experiences natural disasters that have a significant impact on existing residential and commercial structures. Shortages and price increases could cause delays in and increase our costs of home construction, which in turn could harm our operating results.

**Severe weather and other natural conditions or disasters may impair the value of our real estate property.**

Severe weather and other natural conditions or disasters, such as, but not limited to, earthquakes, landslides, hurricanes, tornadoes, tsunamis, volcanic activity, droughts, floods, and heavy or prolonged rain, can negatively affect our operations by requiring us to perform potentially costly repairs to our projects. Further, these conditions can delay

home closings, adversely affect the cost or availability of materials or labor, or impair the value of the property on a temporary or permanent basis. To the extent our insurance is not adequate to cover business interruption losses or repair costs resulting from these events, our total earned revenues and earnings may be adversely affected.

**The homebuilding industry is highly competitive and, with more limited resources than some of our competitors, we may not be able to compete effectively.**

The homebuilding industry is highly competitive. We face competition from other developers on the island of Hawaii and from other luxury residential resort properties in Hawaii and the mainland United States. In many cases, our competitors have greater financial and other resources, more

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established market positions, lower costs of capital, labor and material than we do. Homebuilders compete for, among other things, desirable land, financing, raw materials, skilled labor and purchasers. We compete for residential sales on the basis of a number of interrelated factors, including location, reputation, amenities, design, quality and price, with numerous homebuilders, including some homebuilders with greater financial resources and/or lower costs than us. Increased competition could also reduce the number of homes we deliver, reducing our revenues, or cause us to accept reduced margins to maintain sales volumes. A reduction in our revenue or margins due to competitive factors could affect our ability to service our debt, including the credit facilities.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

**Oil and Natural Gas, Land Investment and Residential Real Estate Properties**

The location and character of Barnwell's oil and natural gas properties, and its land investment and residential real estate properties, are described above under Item 1, Business.

**Corporate Offices**

Barnwell, through wholly-owned subsidiaries, owns the 29th floor of a commercial office building in downtown Honolulu that it uses as its corporate office and a unit in a high rise cooperative apartment in New York City that it utilizes as its New York office.

**ITEM 3. LEGAL PROCEEDINGS**

Barnwell is occasionally involved in routine litigation and is subject to governmental and regulatory controls that are incidental to the business. Barnwell's management believes that routine claims and litigation involving Barnwell are not likely to have a material adverse effect on its financial position, results of operations or liquidity.

**ITEM 4. MINE SAFETY DISCLOSURES**

Disclosure is not applicable to Barnwell.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

The principal market on which Barnwell's common stock is being traded is the NYSE MKT under the ticker symbol BRN. The following tables present the quarterly high and low sales prices, on the NYSE MKT, for Barnwell's common stock during the periods indicated:

| Quarter Ended      | High   | Low    | Quarter Ended      | High   | Low    |
|--------------------|--------|--------|--------------------|--------|--------|
| December 31, 2010  | \$3.69 | \$2.72 | December 31, 2011  | \$3.73 | \$2.70 |
| March 31, 2011     | \$9.01 | \$3.70 | March 31, 2012     | \$4.14 | \$2.60 |
| June 30, 2011      | \$7.75 | \$4.91 | June 30, 2012      | \$3.48 | \$2.79 |
| September 30, 2011 | \$5.20 | \$2.91 | September 30, 2012 | \$3.37 | \$2.87 |

**Holders**

As of December 1, 2012, there were 8,277,160 shares of common stock, par value \$0.50, outstanding. There were approximately 1,341 holders of the common stock of the registrant as of December 1, 2012.

**Dividends**

No dividends were declared or paid during fiscal years 2012 or 2011. The payment of future cash dividends will depend on, among other things, our financial condition, operating cash flows, the amount of cash inflows from land investment activities, and the level of our oil and natural gas capital expenditures.

**Securities Authorized for Issuance Under Equity Compensation Plans**

See the information included in Part III, Item 12, under the caption Equity Compensation Plan Information.

### **Stock Performance Graph and Cumulative Total Return**

Disclosure is not required as Barnwell qualifies as a smaller reporting company.

### **ITEM 6. SELECTED FINANCIAL DATA**

Disclosure is not required as Barnwell qualifies as a smaller reporting company.

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

The following discussion is intended to assist in the understanding of the Consolidated Balance Sheets of Barnwell Industries, Inc. and subsidiaries (collectively referred to herein as Barnwell, we, our, us or the Company ) as of September 30, 2012 and 2011, and the related Consolidated Statements of Operations, Comprehensive (Loss) Income, Cash Flows, and Equity for the years ended September 30, 2012 and 2011. This discussion should be read in conjunction with the consolidated financial statements and related Notes to Consolidated Financial Statements included in this report.

**Use of Estimates in the Preparation of Financial Statements**

The preparation of the financial statements in conformity with U.S. GAAP 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.

**Critical Accounting Policies and Estimates**

The Company considers an accounting estimate to be critical if the accounting estimate requires the Company to make assumptions that are difficult or subjective about matters that were highly uncertain at the time that the accounting estimate was made, and changes in the estimate that are reasonably likely to occur in periods subsequent to the period in which the estimate was made, or use of different estimates that the Company could have used in the current period, would have a material impact on the financial condition or results of operations. The most critical accounting policies inherent in the preparation of the Company's financial statements are described below. We continue to monitor our accounting policies to ensure proper application of current rules and regulations.

*Oil and natural gas properties - full cost ceiling calculation and depletion*

Policy Description

We use the full cost method of accounting for our oil and natural gas properties under which we are required to conduct quarterly calculations of a ceiling, or limitation, on the carrying value of oil and natural gas properties. The ceiling limitation is the sum of 1) the discounted present value (at 10%), using average first-day-of-the-month prices during the 12-month period ending in the reporting period on a constant basis, of Barnwell's estimated future net cash flows from estimated production of proved oil and natural gas reserves, less estimated future expenditures to be incurred in developing and producing the proved reserves but excluding future cash outflows associated with settling asset retirement obligations accrued on the balance sheet; plus 2) the cost of major development projects and unproven properties not subject to depletion, if any; plus 3) the lower of cost or estimated fair value of unproven properties included in costs subject to depletion; less 4) related income tax effects. If net capitalized costs exceed this limit, the excess is expensed.

#### Judgments and Assumptions

The estimate of our oil and natural gas reserves is a major component of the ceiling calculation and represents the component that requires the most subjective judgments. Estimates of reserves are forecasts based on engineering data, historical data, projected future rates of production and the timing of future expenditures. The process of estimating oil and natural gas reserves requires substantial

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judgment, resulting in imprecise determinations, particularly for new discoveries. Our reserve estimates are prepared annually by independent petroleum reserve engineers and quarterly by internal personnel. The passage of time provides more quantitative and qualitative information regarding estimates of reserves, and revisions are made to prior estimates to reflect updated information. In the last three fiscal years, annual revisions to our reserve volume estimates have averaged 2% of the previous year's estimate. However, there can be no assurance that more significant revisions will not be necessary in the future. If future significant revisions are necessary that reduce previously estimated reserve quantities, such revisions could result in a write-down of oil and natural gas properties. If reported reserve volumes were revised downward by 5% at the end of fiscal 2012, the ceiling limitation would have decreased approximately \$2,570,000 before income taxes.

In addition to the impact of the estimates of proved reserves on the calculation of the ceiling, estimated proved reserves are also a significant component of the quarterly calculation of depletion expense. The lower the estimated reserves, the higher the depletion rate per unit of production. Conversely, the higher the estimated reserves, the lower the depletion rate per unit of production. If reported reserve volumes were revised downward by 5% as of the beginning of fiscal 2012, depletion for fiscal 2012 would have increased by approximately \$518,000.

While the quantities of proved reserves require substantial judgment, the associated prices of oil, natural gas and natural gas liquids reserves and the applicable discount rate that are used to calculate the discounted present value of the reserves do not require judgment. The ceiling calculation dictates that a 10% discount factor be used and that average first-day-of-the-month prices during the 12-month period ending in the reporting period are held constant. Costs included in future net revenues are determined in a similar manner. As such, the future net revenues associated with the estimated proved reserves are not based on our assessment of future prices or costs.

*Real Estate Held for Sale and Investment in Residential Parcels*

Policy Description

Real estate held for sale and investment in residential parcels are recorded at the lower of cost or estimated fair value less costs to sell. If an asset's fair value less costs to sell, based on estimated future cash flows, management estimates or market comparisons, is less than its carrying amount, the asset is written down to its estimated fair value less costs to sell.

Judgments and Assumptions

Real estate held for sale and investment in residential parcels are reviewed for possible impairment when events or circumstances indicate that the carrying values may not be recoverable. If the evaluation determines that the recorded value will not be recovered, the carrying value of real estate held for sale and investment in residential parcels are written down to its estimated fair value less costs to sell. This evaluation requires management to make assumptions and apply considerable judgments based on market conditions and comparable sales transactions. Changes in assumptions may require valuation adjustments that may materially impact the Company's financial condition or its future operating results.

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*Investments in Land Interests*

Policy Description

Investments in land interests are recorded at the lower of cost or estimated fair value. If an asset's fair value, based on estimated future cash flows, management estimates or market comparisons, is less than its carrying amount, the asset is written down to its estimated fair value.

Judgments and Assumptions

Investments in land interests are reviewed for possible impairment when events or circumstances indicate that the carrying values may not be recoverable. The estimated future cash flows generated by the asset, management estimates or market comparisons are compared with the amount recorded to assess the recoverability of the carrying value of the asset. If the evaluation determines that the recorded value will not be recovered, our investments in land interests are written down to its estimated fair value. This evaluation requires management to make assumptions and apply considerable judgments to, among others, estimates of the timing and amount of future cash flows, uncertainty about future events, including changes in economic conditions, changes in the use of the assets, and ongoing cost of maintenance and improvements of the assets. Changes in these and other assumptions may require valuation adjustments that may materially impact the Company's financial condition or its future operating results.

*Investment in Joint Ventures*

Policy Description

Joint venture investments are reviewed for possible impairment when events or circumstances indicate that there is an other-than-temporary loss in value. An investment is written down to fair value if there is evidence of a loss in value which is other-than-temporary.

Judgments and Assumptions

The Company's passive investments in joint ventures are reviewed for impairment whenever there is an indication of a loss in value. An investment is written down to fair value if the impairment is other-than-temporary. In determining the fair value of an investment and assessing whether any identified impairment is other-than-temporary, significant estimates and considerable judgment are involved. In evaluating whether an impairment is other-than-temporary, the Company considers all available information, including the length of time and extent of the impairment, the financial condition and near-term prospects of the affiliate, the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value, and projected industry and economic trends. These estimates and judgments are based, in part, on the Company's current and future evaluation of economic conditions, as well as a joint venture's current and future plans to the extent that such plans are known to the Company. Impairment calculations contain additional uncertainties because they require management to make assumptions and apply judgments to estimates of future cash flows, probabilities related to various cash flow scenarios, and appropriate discount rates. Changes in these and other assumptions could affect the projected operational results of the unconsolidated affiliates and, accordingly, may require valuation adjustments to the Company's investments that may materially impact the Company's financial condition or its future operating results.

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*Income taxes*

Policy Description

Income taxes are determined using the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax impacts of differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Barnwell recognizes the financial statement effects of tax positions when it is more likely than not that the position will be sustained by a taxing authority.

Judgments and Assumptions

We make estimates and judgments in determining our income tax expense for each reporting period. Significant changes to these estimates could result in an increase or decrease in our tax provision in future periods. We are also required to make judgments about the recoverability of deferred tax assets and when it is more likely than not that all or a portion of deferred tax assets will not be realized, a valuation allowance is provided. Accordingly, changes in our business performance, unforeseen events, and changes in estimates of future taxable income could require a further increase in the valuation allowance or a reversal in the valuation allowance in future periods. This could result in a charge to, or an increase in, income in the period such determination is made, and the impact of these changes could be material.

In addition, Barnwell operates within the U.S. and Canada and is subject to audit by taxing authorities in these jurisdictions. Barnwell records accruals for the estimated outcomes of these audits, and the accruals may change in the future due to new developments in each matter. Tax benefits are recognized when we determine that it is more likely than not that such benefits will be realized. Management evaluates its potential exposures from tax positions taken that have or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statutes, regulations and rules. Management considers the possibility of alternative outcomes based upon past experience, previous actions by taxing authorities (e.g., actions taken in other jurisdictions) and advice from tax

experts. Where uncertainty exists due to the complexity of income tax statutes and where the potential tax amounts are significant, we generally seek independent tax opinions to support our positions. If our evaluation of the likelihood of the realization of benefits is inaccurate, we could incur additional income tax and interest expense that would adversely impact earnings, or we could receive tax benefits greater than anticipated which would positively impact earnings, either of which could be material.

Management believes that Barnwell's provision for uncertain tax positions is reasonable. However, the ultimate resolution of tax treatments disputed by governmental authorities may adversely affect Barnwell's current and deferred income tax amounts.

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*Asset Retirement Obligation*

Policy Description

Barnwell records the fair value of a liability for an asset retirement obligation in the period in which it is incurred. 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. When the assumptions used to estimate a recorded asset retirement obligation change, a revision is recorded to both the asset retirement obligation and the capitalized cost of asset retirements. The liability is accreted at the end of each period through charges to oil and natural gas operating expense.

Judgments and Assumptions

The asset retirement obligation is recorded at fair value in the period in which it is incurred along with a corresponding increase in the carrying amount of the related asset. Barnwell has estimated fair value by discounting the estimated future cash outflows required to settle abandonment and restoration liabilities. The present value calculation includes numerous estimates, assumptions and judgments regarding the existence of liabilities, the amount and timing of cash outflows required to settle the liability, what constitutes adequate restoration, inflation factors, credit adjusted discount rates, and consideration of changes in legal, regulatory, environmental and political environments. Abandonment and restoration cost estimates are determined in conjunction with Barnwell's reserve engineers based on historical information regarding costs incurred to abandon and restore similar well sites, information regarding current market conditions and costs, and knowledge of subject well sites and properties. The process of estimating the asset retirement obligation requires substantial judgment and use of estimates, resulting in imprecise determinations. Actual asset retirement obligations through the end of fiscal 2012 have not materially differed from our estimates. However, because of the inherent imprecision of estimates as described above, there can be no assurance that material differences will not occur in the future. A 20% increase in accretion and depletion of the asset retirement obligation would have increased Barnwell's fiscal 2012 expenses before taxes by approximately \$186,000.

**Contractual Obligations**

Disclosure is not required as Barnwell qualifies as a smaller reporting company.

## Overview

Barnwell is engaged in the following lines of business: 1) exploring for, developing, producing and selling oil and natural gas in Canada (oil and natural gas segment), 2) investing in land interests in Hawaii (land investment segment), 3) drilling wells and installing and repairing water pumping systems in Hawaii (contract drilling segment), and 4) developing homes for sale in Hawaii (residential real estate segment).

### *Oil and Natural Gas Segment*

Barnwell is involved in the acquisition, exploration and development of oil and natural gas properties in Canada where we initiate and participate in exploratory and developmental operations for oil and natural gas on properties in which we have an interest, and evaluate proposals by third parties with regard to participation in such exploratory and developmental operations elsewhere.

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Barnwell sells substantially all of its oil and natural gas liquids production under short-term contracts with marketers of oil. Natural gas sold by Barnwell is generally sold under both long-term and short-term contracts with prices indexed to market prices. The price of natural gas, oil and natural gas liquids is freely negotiated between the buyers and sellers. Oil and natural gas prices are determined by many factors that are outside of our control. Market prices for oil and natural gas products are dependent upon factors such as, but not limited to, changes in market supply and demand, which are impacted by overall economic activity, changes in weather, pipeline capacity constraints, inventory storage levels, and output. Petroleum and natural gas prices are very difficult to predict and fluctuate significantly. Natural gas prices tend to be higher in the winter than in the summer due to increased demand, although this trend has become less pronounced due to the increased use of natural gas to generate electricity for air conditioning in the summer and increased natural gas storage capacity in North America.

Oil and natural gas exploration, development and operating costs generally follow trends in product market prices, thus in times of higher product prices the cost of exploring, developing and operating the oil and natural gas properties will tend to escalate as well. Capital expenditures are required to fund the exploration, development, and production of oil and natural gas. Cash outlays for capital expenditures are largely discretionary, however, a minimum level of capital expenditures is required to replace depleting reserves. Due to the nature of oil and natural gas exploration and development, significant uncertainty exists as to the ultimate success of any drilling effort.

*Land Investment Segment*

The land investment segment is comprised of the following three components:

1) Barnwell owns a 77.6% controlling interest in Kaupulehu Developments, a Hawaii general partnership which owns interests in leasehold land at Kaupulehu located approximately six miles north of the Kona International Airport in the North Kona District of the island of Hawaii, adjacent to Hualalai Resort at Historic Kaupulehu, between the Queen Kaahumanu Highway and the Pacific Ocean. Kaupulehu Developments' interests include the following:

- The right to receive payments from WB and WBKD, entities not affiliated with Barnwell and its subsidiaries, resulting from the sale of lots and/or residential units within approximately 870 acres of the Kaupulehu Lot 4A area by WB and WBKD in two increments ( Increment I and Increment II ). Increment I is an area planned for approximately 80 single-family lots and a beach club on the portion of the property bordering the Pacific Ocean. The purchasers of the 80 single-family lots will have the right to apply for membership in the Kūkiō Golf and Beach Club, which is located adjacent to and south of the Four Seasons Resort Hualalai at Historic Kaupulehu. Increment II is the remaining portion of the approximately 870-acre property, is currently undeveloped, and is zoned for single-family and multi-family residential units and a golf course and clubhouse.

- Approximately 1,000 acres of vacant leasehold land zoned conservation in the Kaupulehu Lot 4C area located adjacent to the 870-acre Lot 4A described above. Kaupulehu Developments has an agreement which provides WB and/or WBKD the exclusive right to negotiate with Kaupulehu Developments with respect to these 1,000 acres. This right expires in June 2013 unless extended by Barnwell.

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2) Barnwell owns an 80% controlling interest in Kaupulehu 2007, a Hawaii limited liability limited partnership. Kaupulehu 2007 owns two residential parcels in the Kaupulehu area that are held for investment.

3) Barnwell, through wholly-owned Kaupulehu Mauka Investors, LLC, owns acquisition rights as to 14 lots within agricultural-zoned leasehold land in the upland area of Kaupulehu ( Mauka Lands ) situated between the Queen Kaahumanu Highway and the Mamalahoa Highway at Kaupulehu, on the island of Hawaii. The acquisition rights give Barnwell the right to acquire 14 residential lots, currently estimated to be two to five acres in size, which may be developed on the Mauka Lands. These lands are currently classified as agricultural by the state of Hawaii and, accordingly, the developer of these lands (Hualalai Investors) will need to pursue both state and county of Hawaii approvals for reclassification and rezoning to permit the development of residential lots and negotiate development terms.

*Contract Drilling Segment*

Barnwell drills water, water monitoring and geothermal wells and installs and repairs water pumping systems in Hawaii. Contract drilling results are highly dependent upon the quantity, dollar value and timing of contracts awarded by governmental and private entities and can fluctuate significantly.

*Residential Real Estate Segment*

Barnwell, through its 80%-owned real estate joint venture, Kaupulehu 2007, constructs and sells luxury single-family homes. Kaupulehu 2007, in addition to the two parcels described above, owns a luxury residence in the Kaupulehu area that is available for sale. Kaupulehu 2007 does not currently have any homes under construction.

*Investment in Joint Ventures*

Kaupulehu Investors, LLC, a limited liability company 80%-owned by Barnwell, owns 1.5% passive minority interests in Hualalai Investors JV, LLC and Hualalai Investors II, LLC, owners of Hualalai Resort, and a 1.5% passive minority interest in Kona Village Investors, LLC, owner of Kona Village Resort.

## **Business Environment**

Our operations are located in Canada and in the state of Hawaii. Accordingly, our business performance is directly affected by macroeconomic conditions in those areas, as well as general economic conditions of the U.S. domestic and world economies. Current global economic conditions differentiate recent times from years past, and sluggish demand continues to impact all of the Company's segments in both Hawaii and Canada.

### *Oil and Natural Gas Segment*

Historically, oil and natural gas prices have been highly volatile. Demand for natural gas also changes from season to season.

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Natural gas prices hit their lowest price in a decade during 2012, and in recent years demand for natural gas has been weak according to Canada's National Energy Board. The key contributing factor to the decline in demand is the economic recession which has led to reduced worldwide natural gas consumption. In addition, the discovery and availability of natural gas from shale has resulted in an oversupply of natural gas in North America. The economic recession also continues to impact oil prices due to reduced demand. The current low natural gas price environment has caused the Company to reduce its planned capital spending for fiscal 2013. This level of oil and natural gas capital expenditures is likely insufficient to maintain current production and reserve levels.

*Land Investment and Residential Real Estate Segments*

Kaupulehu 2007's luxury home is a 5-bedroom, 6.5-bath ranch-style home, 6,275 square feet in size and is available for sale. Barnwell will have continuing cash outflows such as debt repayments, interest, maintenance, property taxes, and other holding costs until the home and lots held for investment are sold.

Demand for developed residential homes and lots within the Kaupulehu area remains slow. Furthermore, we do not control or determine when or if the remainder of Increment I or Increment II will be developed. If real estate activity in the Kaupulehu area does not increase, our operating results, financial condition, liquidity and cash flows could be adversely affected.

*Contract Drilling Segment*

Demand for water well drilling and/or pump installation and repair services is volatile and dependent upon land development activities within the state of Hawaii. The most recent State of Hawaii Department of Business, Economic Development and Tourism forecast suggests that although both the value of permits issued for private development and the number of government contracts awarded increased, the construction industry remains somewhat depressed and near-term prospects remain limited. This is evidenced by a decline in construction jobs. Management currently estimates that well drilling activity for fiscal 2013 will be similar to that of fiscal 2012 based upon contracts in backlog and estimates of future job availability.

**Results of Operations**

*Summary*

Barnwell incurred a net loss for fiscal 2012 of \$10,136,000, a \$10,027,000 decrease in operating results from a net loss of \$109,000 in fiscal 2011. This decrease was largely attributable to the following:

- A \$5,557,000 decrease in oil and natural gas segment operating profit, before reduction in carrying value of assets and taxes, primarily resulting from:

Lower natural gas prices, higher depletion expense and lower net natural gas production partially offset by higher net oil production; and

The prior year period included a \$1,424,000 gain from third-party drilling royalty credits as compared to no such gain in the current year.

- A \$5,419,000 increase in reductions of the carrying value of assets in the current year as compared to the prior year. The current year includes a \$2,551,000 reduction of the carrying value of oil and natural gas properties, a \$1,854,000 write-down of real estate held for sale, a \$1,754,000 write-off of our investment in joint ventures, and a \$488,000 write-off of our lot acquisition rights, whereas the prior year includes write-downs of Barnwell's investment in residential parcels and real estate held for sale and a write-off of our investment in Kona Village Investors, LLC totaling \$1,228,000.

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- A \$3,260,000 decrease in land investment segment operating profit, before income taxes and non-controlling interests' share of such profits (and excluding the impact of the reduction in carrying value discussed above), as there were no development rights option receipts and decreased percentage of sales receipts in the current year.

The decrease was partially offset by a \$757,000 decrease in general and administrative expenses due primarily to decreased stock appreciation rights expense and bonus expense.

*General*

Barnwell conducts operations in the U.S. and Canada. Consequently, Barnwell is subject to foreign currency translation and transaction gains and losses due to fluctuations of the exchange rates between the Canadian dollar and the U.S. dollar. The impact of fluctuations of the exchange rates between the Canadian dollar and the U.S. dollar may be material from period to period. Barnwell cannot accurately predict future fluctuations between the Canadian and U.S. dollar.

The average exchange rate of the Canadian dollar to the U.S. dollar decreased 2% in fiscal 2012, as compared to fiscal 2011, and the exchange rate of the Canadian dollar to the U.S. dollar increased 6% at September 30, 2012, as compared to September 30, 2011. Accordingly, the assets, liabilities, stockholders' equity, and revenues and expenses of Barnwell's subsidiaries operating in Canada have been adjusted to reflect the change in the exchange rates. Barnwell's Canadian dollar assets are greater than its Canadian dollar liabilities; therefore, increases or decreases in the value of the Canadian dollar to the U.S. dollar generate other comprehensive income or loss, respectively. Other comprehensive income and losses are not included in net (loss) earnings. The other comprehensive income due to foreign currency translation adjustments, net of taxes, for fiscal 2012 was \$1,927,000, a \$2,373,000 change from other comprehensive loss due to foreign currency translation adjustments, net of taxes, of \$446,000 in fiscal 2011. There were no taxes on other comprehensive (loss) income due to foreign currency translation adjustments in fiscal 2012 and 2011 due to a full valuation allowance on the related deferred tax assets.

Realized foreign currency transaction gains or losses were inconsequential in fiscal 2012 and 2011.

The impact of fluctuations of the exchange rates between the Canadian dollar and the U.S. dollar may be material from period to period. Barnwell cannot accurately predict future fluctuations between Canadian and U.S. dollars.



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The following tables set forth Barnwell's annual average prices per unit of production and annual net production volumes for fiscal 2012 as compared to fiscal 2011. Production amounts reported are net of royalties.

|                    | 2012     | 2011     | Annual Average Price Per Unit |            |
|--------------------|----------|----------|-------------------------------|------------|
|                    |          |          | \$                            | Decrease % |
| Natural gas (Mcf)* | \$ 2.03  | \$ 3.42  | \$ (1.39)                     | (41%)      |
| Oil (Bbls)         | \$ 83.83 | \$ 84.96 | \$ (1.13)                     | (1%)       |
| Liquids (Bbls)     | \$ 46.48 | \$ 49.23 | \$ (2.75)                     | (6%)       |

|                   | 2012      | 2011      | Annual Net Production |                       |
|-------------------|-----------|-----------|-----------------------|-----------------------|
|                   |           |           | Units                 | Increase (Decrease) % |
| Natural gas (Mcf) | 2,753,000 | 2,950,000 | (197,000)             | (7%)                  |
| Oil (Bbls)        | 168,000   | 157,000   | 11,000                | 7%                    |
| Liquids (Bbls)    | 91,000    | 93,000    | (2,000)               | (2%)                  |

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\* Natural gas price per unit is net of pipeline charges.

Oil and natural gas revenues decreased \$4,194,000 (15%) from \$28,804,000 in fiscal 2011 to \$24,610,000 in fiscal 2012, primarily due to decreases in natural gas prices and net natural gas production, which decreased 41% and 7%, respectively, as compared to the prior year. The decrease was partially offset by a 7% increase in net oil production, as compared to the prior year.

At Dunvegan, net natural gas production decreased 16,000 Mcf or 1%. Natural production declines at Dunvegan were partially offset by a lower royalty rate and the fact that Dunvegan natural gas was produced throughout fiscal 2012, whereas a scheduled plant and pipeline maintenance shutdown in the prior year reduced Dunvegan net natural gas production by 60,000 Mcf in fiscal 2011. Dunvegan contributed 67% of Barnwell's net natural gas production in fiscal

2012, as compared to 64% in fiscal 2011, and natural gas production from the Dunvegan Unit was responsible for 62% of Barnwell's natural gas revenue in fiscal 2012, as compared to 60% in fiscal 2011.

Net natural gas production at all other properties decreased 17% due to both natural declines and wells being shut in during the year. Due to the significant decline and continued depression of natural gas prices, certain natural gas wells were shut in by the Company and independent operators of such properties in fiscal 2012 due to economic or operational issues. Net natural gas production from these wells in the prior year accounted for approximately 8% of the net natural gas production for that period. Future additional wells being shut in may result in the Company receiving materially less than anticipated production or no production and associated revenues from affected properties until the Company or independent operator elects to return such wells to production. The impact of any future natural gas well shut ins is unknown as such events are dependent upon the level of future natural gas prices and the ability to resolve specific operational issues, which the Company is unable to predict.

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The increase in net oil production was due partly to production from newer wells, partially offset by natural declines in production from older properties. Also contributing to the increase in net oil production were lower freehold royalty rates as no freehold royalties were applied to newer wells.

The Company continues to direct the majority of its exploration and development focus on oil rather than natural gas due to the poor outlook for natural gas prices. Accordingly, it is likely that the Company's natural gas and natural gas liquids production will continue to decline as its natural gas properties age.

*Oil and natural gas operating expenses*

Operating expenses decreased \$959,000 (8%) to \$10,445,000 in fiscal 2012, as compared to \$11,404,000 in fiscal 2011, due primarily to lower workover activity and repairs, partially as a result of lower natural gas prices, and lower operating costs resulting from lower production. Also contributing to the decrease was a 2% decrease in the average exchange rate of the Canadian dollar to the U.S. dollar that decreased oil and natural gas operating expenses \$215,000.

*Sale of development rights and Sale of interest in leasehold land*

Kaupulehu Developments received its final development rights option payment from Hualalai Investors, the owner and current developer of Hualalai Resort, in December 2010. Revenues related to sales of development rights under option for the years ended September 30, 2012 and 2011 are summarized as follows:

|                                            | Year ended September 30, |              |
|--------------------------------------------|--------------------------|--------------|
|                                            | 2012                     | 2011         |
| Sale of development rights under option:   |                          |              |
| Proceeds                                   | \$ -                     | \$ 2,656,000 |
| Fees                                       | -                        | (159,000)    |
| Revenues - sale of development rights, net | \$ -                     | \$ 2,497,000 |

The following table summarizes the percentage of sales payment revenues received from WB for the years ended September 30, 2012 and 2011:

|                                                  |    | Year ended September 30,<br><b>2012</b> | 2011         |
|--------------------------------------------------|----|-----------------------------------------|--------------|
| Sale of interest in leasehold land:              |    |                                         |              |
| Proceeds                                         | \$ | <b>512,000</b>                          | \$ 1,325,000 |
| Fees                                             |    | <b>(30,000)</b>                         | (80,000)     |
| Revenues sale of interest in leasehold land, net | \$ | <b>482,000</b>                          | \$ 1,245,000 |

WB sold two single-family lots in Increment I during the year ended September 30, 2012 as compared to three single-family lots during the year ended September 30, 2011.

As of September 30, 2012, 31 of the 38 single-family lots in Phase I of Increment I have been sold by WB. Forty-two single-family lots are planned for Phase II of Increment I, for a total of 80 single-family lots planned for Increment I. The developer recently released and began marketing a portion of the 42 single-family lots in Phase II of Increment I. The Company cannot predict when WB will complete the remaining single-family lots in Phase II of Increment I and there is no assurance with regard to the amounts of future sales from Increment I.

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*Contract drilling*

Contract drilling revenues and costs are associated with well drilling and water pump installation, replacement and repair in Hawaii.

Contract drilling revenues decreased \$1,515,000 (39%) to \$2,340,000 in fiscal 2012, as compared to \$3,855,000 in fiscal 2011, and contract drilling costs decreased \$891,000 (23%) to \$2,991,000 in fiscal 2012, as compared to \$3,882,000 in fiscal 2011. The contract drilling segment generated a \$1,160,000 operating loss before general and administrative expenses during fiscal 2012, a decrease in operating results of \$573,000 as compared to an operating loss before general and administrative expenses of \$587,000 in fiscal 2011. The decrease in operating results was due to lower well drilling activity as compared to the prior year and increased losses on certain pump installation and repair contracts due to unforeseen difficulties.

At September 30, 2012, there was a backlog of three well drilling and eight pump installation and repair contracts, of which two well drilling and four pump installation and repair contracts were in progress as of September 30, 2012. The backlog of contract drilling revenues as of December 1, 2012 was approximately \$1,320,000. All of the contracts in backlog at December 1, 2012 are expected to be completed within fiscal year 2013.

Contract drilling revenues and costs are not seasonal in nature, but can fluctuate significantly based on the awarding and timing of contracts, which are determined by contract drilling customer demand. There has been a significant decrease in demand for water well drilling contracts in the last three years due largely to the impact of the recession and continuing weak economic conditions on both private real estate development and governmental capital improvement budgets. Lack of availability of contracts has also resulted in increased competition for available contracts, which generally has resulted in lower estimated margins on awarded contracts. Continued lack of water well drilling contracts may necessitate future cost reduction measures, temporary shutdown of water well drilling operations, or sale or liquidation of a portion of our contract drilling equipment. The Company is unable to predict the near-term and long-term availability of water well drilling and pump installation and repair contracts as the duration of the slowdown in construction activity is unknown.

*Residential real estate revenues and expenses*

During the quarter ended June 30, 2012, one of the luxury residences was sold for \$5,975,000. The carrying value of the home sold and costs related to the sale totaled \$5,990,000, resulting in a nominal loss.

*Gas processing and other*

Gas processing and other income decreased \$1,404,000 (68%) to \$655,000 in fiscal 2012, as compared to \$2,059,000 in fiscal 2011. The decrease was primarily attributable to a gain from drilling royalty credits of \$1,424,000 in fiscal 2011 due to the purchase of third-party drilling royalty credits by the oil and natural gas segment for less than par value; no third-party drilling royalty credits were purchased during fiscal 2012. Under an incentive program that expired in fiscal 2011, the Canadian province of Alberta provided temporary drilling royalty credits to eligible companies which drilled new conventional oil and natural gas wells on Alberta crown lands. Certain companies earned drilling

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royalty credits in excess of a formulaic maximum, which resulted in such companies being unable to fully claim their drilling royalty credits. Barnwell had limited drilling activity and thus acquired drilling royalty credits for less than par value from entities with excess drilling royalty credits allowing Barnwell to realize these gains. The drilling royalty credit program ended in the prior year and in the absence of legislation to renew the program, gains from purchased drilling royalty credits will not occur in future periods.

*General and administrative expenses*

General and administrative expenses decreased \$757,000 (8%) to \$8,268,000 in fiscal 2012, as compared to \$9,025,000 in fiscal 2011. The decrease was primarily due to the fact that general and administrative expenses decreased \$507,000 as fiscal 2011 included \$404,000 of stock appreciation rights expense resulting from a significant increase in the market price of the Company's stock, as compared to a \$103,000 reduction in stock appreciation rights expense in the current year resulting from a decline in the market price of the Company's stock. Also contributing to the decrease was a \$304,000 decrease in current compensation costs, largely due to decreased bonus expense.

*Depletion, depreciation, and amortization*

Depletion, depreciation and amortization increased \$863,000 (9%) to \$10,990,000 in fiscal 2012, as compared to \$10,127,000 in fiscal 2011, as a result of a 15% increase in the depletion rate, partially offset by a 3% decrease in net production and a 2% decrease in the average exchange rate of the Canadian dollar to the U.S. dollar. The increase in the depletion rate was due to increases in Barnwell's costs of finding and developing proven reserves and the drilling of unsuccessful wells.

*Reduction of carrying value of assets*

During fiscal years 2012 and 2011, Barnwell reduced the carrying value of certain assets. A breakdown of the reduction of the carrying value of assets as reported in the Consolidated Statements of Operations is as follows:

|                                | Year ended September 30, |         |
|--------------------------------|--------------------------|---------|
|                                | 2012                     | 2011    |
| Oil and natural gas properties | \$ 2,551,000             | \$ -    |
| Real estate held for sale      | 1,854,000                | 418,000 |

|                                             |                     |                     |
|---------------------------------------------|---------------------|---------------------|
| Investment in residential parcels           | -                   | 689,000             |
| Investment in joint ventures                | <b>1,754,000</b>    | 121,000             |
| Lot acquisition rights - Mauka Lands        | <b>488,000</b>      | -                   |
| Total reduction of carrying value of assets | <b>\$ 6,647,000</b> | <b>\$ 1,228,000</b> |

Under the full cost method of accounting, we are required to perform quarterly ceiling test calculations. Barnwell's net capitalized costs exceeded the ceiling limitation at September 30, 2012. As such, Barnwell reduced the carrying value of its oil and natural gas properties by \$2,551,000 during the year ended September 30, 2012. No such reduction was necessary during fiscal 2011.

Based on the impact of first-day-of-the-month oil, natural gas and natural gas liquids prices during the first quarter of fiscal 2013 on the 12-month average first-day-of-the-month trailing prices used in the calculation of the ceiling limitation, the Company may be required to record a reduction in carrying value of its oil and natural gas properties in its first quarter of fiscal 2013. The Company is unable to estimate a range of the amount of the potential reduction in carrying value as other variables that potentially impact the ceiling limitation are dependent upon results of activity during the first quarter of fiscal 2013, which is not yet complete as of the date of this filing.

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In April 2012, Kaupulehu 2007 entered into a contract to sell one of the luxury residences at a price below carrying value. Accordingly, Barnwell recorded a \$1,854,000 reduction in the carrying values of both houses held for sale to reflect this decline in the estimated market value of the two luxury residences in fiscal 2012. During fiscal 2011, Barnwell determined that a reduction of the carrying value of its investment in residential parcels and real estate held for sale was necessary and recorded write-downs of \$689,000 and \$418,000, respectively, primarily as a result of changes in fair values for real estate in the Lot 4A Increment I area of Kaupulehu, North Kona, Hawaii.

Due to recent uncertainty regarding the financial condition of the joint venture entities in which the Company has passive interests and the duration of current economic conditions and the corresponding impact of such conditions on the Company's ability to recover its investment within the Company's currently estimated holding period, the Company wrote off its remaining \$1,754,000 investment in joint ventures in fiscal 2012 as management has concluded that there has been an other-than-temporary impairment of these investments. Kona Village Resort sustained considerable damage as a result of the March 2011 tsunami and subsequently shut down indefinitely. As such, Barnwell wrote off its remaining investment in Kona Village Investors, LLC of \$121,000 during fiscal 2011.

Due to recent heightened uncertainty regarding the likelihood of development of the Mauka Lands, and accordingly, the corresponding impact of such conditions on the Company's ability to recover its investment in lot acquisition rights, the Company wrote off its remaining \$488,000 investment in lot acquisition rights in fiscal 2012.

*Interest expense*

Interest expense decreased \$298,000 (27%) to \$790,000 in fiscal 2012, as compared to \$1,088,000 in fiscal 2011, primarily due to lower borrowings, interest rates and loan commitment fees.

The majority of Barnwell's debt is denominated in U.S. dollars. Therefore, the increase in the average exchange rate of the Canadian dollar to the U.S. dollar had a minimal impact on interest expense.

*Income taxes*

The components of (loss) earnings before income taxes, after adjusting (loss) earnings for non-controlling interests, are as follows:

|               | Year ended September 30, |                |
|---------------|--------------------------|----------------|
|               | 2012                     | 2011           |
| United States | \$ (8,936,000)           | \$ (4,148,000) |
| Canada        | (2,297,000)              | 5,540,000      |
|               | \$ (11,233,000)          | \$ 1,392,000   |

Barnwell's effective consolidated income tax rate for fiscal 2012, after adjusting (loss) earnings before income taxes for non-controlling interests, was 10%, as compared to 108% for fiscal 2011.

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Consolidated taxes do not bear a customary relationship to pretax (losses) earnings due mainly to the fact that Canadian income taxes are not sheltered by U.S. source losses, Canadian income taxes are not estimated to have a current or future benefit as foreign tax credits or deductions for U.S. tax purposes, and U.S. consolidated net operating losses are not estimated to have a future U.S. tax benefit prior to expiration. In addition, included in the income tax benefit for fiscal 2012 and the income tax provision for fiscal 2011 are \$93,000 and \$257,000 uncertain tax position benefits, respectively, from lapses of the statute of limitations for uncertain tax positions related to Canadian income taxes. The Canada Revenue Agency is currently examining the Company's Canadian federal income tax returns for fiscal 2010 and 2011.

*Net (loss) earnings attributable to non-controlling interests*

Earnings and losses attributable to non-controlling interests represent the non-controlling interests' share of revenues and expenses related to the various partnerships and joint ventures in which Barnwell has interests.

Net loss attributable to non-controlling interests totaled \$826,000 in fiscal 2012, as compared to net earnings attributable to non-controlling interests of \$314,000 in fiscal 2011. The \$1,140,000 (363%) change is due primarily to impacts to non-controlling interests of larger write-downs of Barnwell's assets and lower revenues reported by the land investment segment in the current year as compared to the prior year.

*Inflation*

The effect of inflation on Barnwell has generally been to increase its cost of operations, interest cost (as a substantial portion of Barnwell's debt is at variable short-term rates of interest which tend to increase as inflation increases), general and administrative costs and direct costs associated with oil and natural gas production and contract drilling operations. Oil and natural gas prices realized by Barnwell are essentially determined by world prices for oil and western Canadian/Midwestern U.S. prices for natural gas.

*Impact of Recently Issued Accounting Standards on Future Filings*

Presentation of Comprehensive Income

In June 2011, the FASB issued an accounting standards update that eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity, among other updates to the presentation of comprehensive income. Under this guidance, an entity has the option to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In addition, an entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. In December 2011, the FASB issued an accounting standards update that defers the effective date of the requirement to present separate line items on the income statement for reclassification adjustments of items out of accumulated other comprehensive income into net income. The deferral is temporary until the FASB reconsiders the operational concerns and needs of financial statement users. The requirement to present comprehensive income in either a single continuous statement or two consecutive condensed statements is effective for fiscal years beginning after December 15, 2011, with early adoption permitted. Adoption of the deferred requirement of this standard will impact the presentation of the Company's consolidated financial statements.

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**Liquidity and Capital Resources**

Barnwell's primary sources of liquidity are cash on hand, cash flows from operations, land investment segment proceeds and available credit. At September 30, 2012, Barnwell had \$8,845,000 in cash and cash equivalents, \$4,570,000 in working capital, and \$8,332,000 of available credit under its credit facility with its Canadian bank.

*Cash Flows*

Cash flows provided by operations totaled \$11,466,000 for fiscal 2012, as compared to \$13,263,000 of cash flows provided by operations for the same period in fiscal 2011, a decrease of \$1,797,000. The decrease was primarily due to changes in working capital of \$2,703,000, the absence of the prior year's gain on drilling royalty credits in the current year, and lower natural gas prices as compared to the prior year, partially offset by \$5,477,000 of operating cash flows related to the sale of real estate and additions to real estate held for sale in the current year.

Net cash used in investing activities totaled \$6,277,000 for fiscal 2012, as compared to \$11,473,000 of cash flows used in investing activities for the same period in fiscal 2011. Cash outflows used for capital expenditures totaled \$6,879,000 for the current year period versus \$15,313,000 in the prior year period, a decrease of \$8,434,000 due primarily to lower oil and natural gas capital expenditures in the current year and the prior year purchase of an office in New York City by a subsidiary of the Company. Investing cash inflows were \$602,000 for the current year period as opposed to \$3,840,000 in the prior year period, a \$3,238,000 decrease, due mainly to lower land investment segment proceeds in the current year.

Cash flows used in financing activities totaled \$6,209,000 for fiscal 2012, as compared to \$2,689,000 of cash flows used in financing activities for fiscal 2011. The \$3,520,000 increase in cash outflows is primarily due to a \$4,264,000 increase in debt repayments resulting largely from the sale of one luxury residence in June 2012. The increase was partially offset by a \$711,000 decrease in distributions to non-controlling interests due to decreased land investment segment sales in the current year period as compared to the comparable prior year period.

*Credit Arrangements*

In February 2012, Barnwell's credit facility at Royal Bank of Canada, a Canadian bank, was renewed through April 2013 for \$20,000,000 Canadian dollars, unchanged from the prior year amount, or US\$20,332,000 at the

September 30, 2012 exchange rate of 1.0166. Borrowings under this facility were US\$12,000,000 and unused credit available under this facility was US\$8,332,000 at September 30, 2012. The interest rate on the facility at September 30, 2012 was 2.73%. The facility is available in U.S. dollars at LIBOR plus 2.50%, at the Royal Bank U.S. base rate plus 1.50%, or in Canadian dollars at the Royal Bank prime rate plus 1.50%. A standby fee of 0.6250% per annum is charged on the unused facility balance.

Barnwell, together with its 80%-owned real estate joint venture, Kaupulehu 2007, has a non-revolving real estate loan with a Hawaii bank that terminates on April 1, 2018. Principal and interest are paid monthly and are determined based on a loan amortization schedule. Monthly payments of principal and interest are due on the first day of each month and will change as a result of an annual

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change in the interest rate, the sale of a house or the sale of a residential parcel. As a result of the sale of one of its homes in June 2012, Kaupulehu 2007 repaid \$5,277,000 of the real estate loan in addition to the scheduled monthly payments. In September 2012, the loan was modified to reduce the monthly payments of principal and interest to \$58,000.

The interest rate adjusts each April for the remaining term of the loan to the lender's then prevailing interest rate for similarly priced commercial mortgage loans or a floating rate equal to the lender's base rate. The interest rate at September 30, 2012 was 3.57%. Any unpaid principal balance and accrued interest will be due and payable on April 1, 2018. The loan is collateralized by, among other things, a first mortgage on Kaupulehu 2007's lots together with all improvements thereon. Kaupulehu 2007 will be required to make a principal payment upon the sale of a house or a residential parcel in the amount of the net sales proceeds of the house or residential parcel; the loan agreement defines net sales proceeds as the gross sales proceeds for the house or residential parcel, less reasonable commissions and normal closing costs.

The non-revolving real estate loan agreement contains provisions requiring us to maintain compliance with certain covenants including a consolidated debt service coverage ratio of not less than 1.20 to 1 and a consolidated total liabilities to tangible net worth ratio not to exceed 1.85 to 1. As of September 30, 2012, we were in compliance with the loan covenants.

*Oil and Natural Gas Capital Expenditures*

Barnwell's oil and natural gas capital expenditures, including accrued capital expenditures, decreased \$8,384,000 (63%) from \$13,299,000 in fiscal 2011 to \$4,915,000 in fiscal 2012. During the year ended September 30, 2012, Barnwell participated in drilling eight gross (3.0 net) wells, of which six gross (1.7 net) wells were successful. Barnwell initiated five gross (2.7 net) of these wells during fiscal 2012. Barnwell replaced 22% of oil production (including natural gas liquids) and 1% of natural gas production during fiscal 2012, as compared to 48% and 11%, respectively, during fiscal 2011. Of the \$4,915,000 total oil and natural gas properties investments for fiscal 2012, \$496,000 (10%) was for acquisition of oil and natural gas leases, \$1,778,000 (36%) was for exploration costs and \$2,641,000 (54%) was for development of oil and natural gas properties.

The following table sets forth the gross and net numbers of oil and natural gas wells Barnwell participated in drilling for the last two fiscal years:

**2012**

**2011**

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|                                        | <b>Gross</b> | <b>Net</b> | Gross | Net |
|----------------------------------------|--------------|------------|-------|-----|
| Exploratory oil and natural gas wells  | <b>1</b>     | <b>0.5</b> | 1     | 0.5 |
| Development oil and natural gas wells  | <b>7</b>     | <b>2.5</b> | 17    | 3.9 |
| Successful oil and natural gas wells   | <b>6</b>     | <b>1.7</b> | 16    | 3.4 |
| Unsuccessful oil and natural gas wells | <b>2</b>     | <b>1.3</b> | 2     | 1.0 |

Barnwell estimates that oil and natural gas capital expenditures for fiscal 2013 will range from \$5,000,000 to \$7,000,000. This estimated amount may increase or decrease as dictated by cash flows and management's assessment of the oil and natural gas environment and prospects.

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*Other Considerations*

We believe our sources of funds such as current cash balances, future operating cash flows, land investment segment proceeds, and available credit will provide sufficient liquidity to fund our operations, planned future capital expenditures, and scheduled debt repayments and related interest. However, in the event oil and natural gas prices and production, land investment segment proceeds, and residential real estate home sale proceeds are less than current expectations, Barnwell's Canadian revolving credit facility is reduced below the current level of borrowings under the facility upon the April 2013 review, and/or we fall short of our key financial debt covenants for our real estate loan and are required to repay a portion of our loan borrowings earlier than anticipated, we will be faced with reduced cash inflows and/or higher cash outflows than expected, which in turn could have a material adverse effect on our operations, liquidity, cash flows and financial condition. Absent a sufficient increase in natural gas and/or oil prices, it is unlikely that future oil and natural gas operating cash flows will be sufficient to fund the capital expenditure levels necessary to maintain current production and reserve levels. As such, the near-term and longer-term outlook for sources and uses of funds and oil and natural gas capital resources remains highly dependent on the factors noted above.

In the event our liquidity and capital resources are not sufficient to fund our future cash needs, the Company will need to obtain alternative terms or sources of financing or liquidate investments and/or operating assets to make any required cash outflows. Events and circumstances that lead to results that significantly differ from management's expectations could have a material adverse effect on our operations, liquidity, cash flows, and financial condition.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Disclosure is not required as Barnwell qualifies as a smaller reporting company.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors  
Barnwell Industries, Inc.:

We have audited the accompanying consolidated balance sheets of Barnwell Industries, Inc. and subsidiaries as of September 30, 2012 and 2011, and the related consolidated statements of operations, comprehensive (loss) income, cash flows, and equity for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Barnwell Industries, Inc. and subsidiaries as of September 30, 2012 and 2011, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Honolulu, Hawaii  
December 12, 2012



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## BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

|                                                                          | 2012          | September 30, | 2011       |
|--------------------------------------------------------------------------|---------------|---------------|------------|
| <b><u>ASSETS</u></b>                                                     |               |               |            |
| Current assets:                                                          |               |               |            |
| Cash and cash equivalents                                                | \$ 8,845,000  | \$            | 9,834,000  |
| Accounts receivable, net of allowance for doubtful accounts              | 3,600,000     |               | 5,760,000  |
| Prepaid expenses                                                         | 361,000       |               | 298,000    |
| Real estate held for sale                                                | 5,309,000     |               | 12,640,000 |
| Other current assets                                                     | 770,000       |               | 998,000    |
| Total current assets                                                     | 18,885,000    |               | 29,530,000 |
| Investments                                                              | 2,381,000     |               | 4,623,000  |
| Property and equipment, net                                              | 48,624,000    |               | 54,619,000 |
| Total assets                                                             | \$ 69,890,000 | \$            | 88,772,000 |
| <b><u>LIABILITIES AND EQUITY</u></b>                                     |               |               |            |
| Current liabilities:                                                     |               |               |            |
| Accounts payable                                                         | \$ 2,680,000  | \$            | 2,750,000  |
| Accrued capital expenditures                                             | 341,000       |               | 2,492,000  |
| Accrued compensation                                                     | 1,593,000     |               | 2,397,000  |
| Payable to joint interest owners                                         | 854,000       |               | 1,012,000  |
| Income taxes payable                                                     | -             |               | 199,000    |
| Current portion of long-term debt                                        | 5,764,000     |               | 12,314,000 |
| Other current liabilities                                                | 3,083,000     |               | 2,925,000  |
| Total current liabilities                                                | 14,315,000    |               | 24,089,000 |
| Long-term debt                                                           | 11,400,000    |               | 11,400,000 |
| Liability for retirement benefits                                        | 5,114,000     |               | 5,167,000  |
| Asset retirement obligation                                              | 5,629,000     |               | 4,921,000  |
| Deferred income taxes                                                    | 3,307,000     |               | 4,481,000  |
| Total liabilities                                                        | 39,765,000    |               | 50,058,000 |
| Commitments and contingencies                                            |               |               |            |
| Equity:                                                                  |               |               |            |
| Barnwell Industries, Inc. stockholders' equity:                          |               |               |            |
| Common stock, par value \$0.50 per share; authorized, 20,000,000 shares: |               |               |            |
| 8,445,060 issued at September 30, 2012 and 2011                          | 4,223,000     |               | 4,223,000  |
| Additional paid-in capital                                               | 1,289,000     |               | 1,289,000  |
| Retained earnings                                                        | 24,095,000    |               | 34,231,000 |
| Accumulated other comprehensive income, net                              | 2,322,000     |               | 290,000    |

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|                                                      |               |               |
|------------------------------------------------------|---------------|---------------|
| Treasury stock, at cost:                             |               |               |
| 167,900 shares at September 30, 2012 and 2011        | (2,286,000)   | (2,286,000)   |
| Total Barnwell Industries, Inc. stockholders' equity | 29,643,000    | 37,747,000    |
| Non-controlling interests                            | 482,000       | 967,000       |
| Total equity                                         | 30,125,000    | 38,714,000    |
| Total liabilities and equity                         | \$ 69,890,000 | \$ 88,772,000 |

See Notes to Consolidated Financial Statements

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## BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

|                                                                                          | Year ended September 30, |                     |
|------------------------------------------------------------------------------------------|--------------------------|---------------------|
|                                                                                          | 2012                     | 2011                |
| Revenues:                                                                                |                          |                     |
| Oil and natural gas                                                                      | \$ 24,610,000            | \$ 28,804,000       |
| Contract drilling                                                                        | 2,340,000                | 3,855,000           |
| Sale of interest in leasehold land, net                                                  | 482,000                  | 1,245,000           |
| Sale of development rights, net                                                          | -                        | 2,497,000           |
| Residential real estate                                                                  | 5,975,000                | -                   |
| Gas processing and other                                                                 | 655,000                  | 2,059,000           |
|                                                                                          | <b>34,062,000</b>        | <b>38,460,000</b>   |
| Costs and expenses:                                                                      |                          |                     |
| Oil and natural gas operating                                                            | 10,445,000               | 11,404,000          |
| Contract drilling operating                                                              | 2,991,000                | 3,882,000           |
| Residential real estate                                                                  | 5,990,000                | -                   |
| General and administrative                                                               | 8,268,000                | 9,025,000           |
| Depletion, depreciation, and amortization                                                | 10,990,000               | 10,127,000          |
| Reduction of carrying value of assets                                                    | 6,647,000                | 1,228,000           |
| Interest expense                                                                         | 790,000                  | 1,088,000           |
|                                                                                          | <b>46,121,000</b>        | <b>36,754,000</b>   |
| (Loss) earnings before income taxes                                                      | <b>(12,059,000)</b>      | <b>1,706,000</b>    |
| Income tax (benefit) provision                                                           | <b>(1,097,000)</b>       | <b>1,501,000</b>    |
| Net (loss) earnings                                                                      | <b>(10,962,000)</b>      | <b>205,000</b>      |
| Less: Net (loss) earnings attributable to non-controlling interests                      | <b>(826,000)</b>         | <b>314,000</b>      |
| Net loss attributable to Barnwell Industries, Inc.                                       | \$ <b>(10,136,000)</b>   | \$ <b>(109,000)</b> |
| Basic net loss per common share attributable to Barnwell Industries, Inc. stockholders   | \$ <b>(1.22)</b>         | \$ <b>(0.01)</b>    |
| Diluted net loss per common share attributable to Barnwell Industries, Inc. stockholders | \$ <b>(1.22)</b>         | \$ <b>(0.01)</b>    |
| Weighted-average number of common shares outstanding:                                    |                          |                     |
| Basic                                                                                    | <b>8,277,160</b>         | <b>8,277,160</b>    |
| Diluted                                                                                  | <b>8,277,160</b>         | <b>8,277,160</b>    |

See Notes to Consolidated Financial Statements



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BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

|                                                                                                          | Year ended September 30, |            |
|----------------------------------------------------------------------------------------------------------|--------------------------|------------|
|                                                                                                          | 2012                     | 2011       |
| Net (loss) earnings                                                                                      | \$ (10,962,000)          | \$ 205,000 |
| Other comprehensive income:                                                                              |                          |            |
| Foreign currency translation adjustments, net of taxes of \$0                                            | 1,927,000                | (446,000)  |
| Retirement plans:                                                                                        |                          |            |
| Amortization of accumulated other comprehensive loss into net periodic benefit cost, net of taxes of \$0 | 258,000                  | 239,000    |
| Net actuarial (losses) gains arising during the period, net of taxes of \$0                              | (153,000)                | 448,000    |
| Total other comprehensive income                                                                         | 2,032,000                | 241,000    |
| Total comprehensive (loss) income                                                                        | (8,930,000)              | 446,000    |
| Less: Comprehensive (loss) income attributable to non-controlling interests                              | (826,000)                | 314,000    |
| Comprehensive (loss) income attributable to Barnwell Industries, Inc.                                    | \$ (8,104,000)           | \$ 132,000 |

See Notes to Consolidated Financial Statements

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## BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

|                                                                                            | Year ended September 30, |              |
|--------------------------------------------------------------------------------------------|--------------------------|--------------|
|                                                                                            | 2012                     | 2011         |
| Cash flows from operating activities:                                                      |                          |              |
| Net (loss) earnings                                                                        | \$ (10,962,000)          | \$ 205,000   |
| Adjustments to reconcile net (loss) earnings to net cash provided by operating activities: |                          |              |
| Depletion, depreciation, and amortization                                                  | 10,990,000               | 10,127,000   |
| Reduction of carrying value of assets                                                      | 6,647,000                | 1,228,000    |
| Retirement benefits expense                                                                | 728,000                  | 718,000      |
| Accretion of asset retirement obligation                                                   | 363,000                  | 341,000      |
| Foreign exchange gain                                                                      | -                        | (119,000)    |
| Share-based compensation payments                                                          | -                        | (130,000)    |
| Gain on sale of drilling equipment                                                         | (40,000)                 | -            |
| Share-based compensation (benefit) expense                                                 | (103,000)                | 404,000      |
| Asset retirement obligation payments                                                       | (324,000)                | (36,000)     |
| Retirement plan contributions                                                              | (676,000)                | (256,000)    |
| Deferred income tax (benefit) expense                                                      | (1,297,000)              | 675,000      |
| Sale of interest in leasehold land, net                                                    | (482,000)                | (1,245,000)  |
| Sale of development rights, net                                                            | -                        | (2,497,000)  |
| Real estate held for sale                                                                  | 5,477,000                | -            |
| Increase from changes in current assets and liabilities                                    | 1,145,000                | 3,848,000    |
| Net cash provided by operating activities                                                  | 11,466,000               | 13,263,000   |
| Cash flows from investing activities:                                                      |                          |              |
| Proceeds from sale of development rights, net of fees paid                                 | -                        | 2,497,000    |
| Proceeds from sale of interest in leasehold land, net of fees paid                         | 482,000                  | 1,245,000    |
| Proceeds from gas over bitumen royalty adjustments                                         | 61,000                   | 98,000       |
| Proceeds from sale of drilling equipment, net                                              | 59,000                   | -            |
| Capital expenditures                                                                       | (6,879,000)              | (15,313,000) |
| Net cash used in investing activities                                                      | (6,277,000)              | (11,473,000) |
| Cash flows from financing activities:                                                      |                          |              |
| Repayments of long-term debt                                                               | (6,550,000)              | (2,286,000)  |
| Contributions from non-controlling interests                                               | 370,000                  | 400,000      |
| Payment of loan commitment fees                                                            | -                        | (63,000)     |
| Distributions to non-controlling interests                                                 | (29,000)                 | (740,000)    |
| Net cash used in financing activities                                                      | (6,209,000)              | (2,689,000)  |
| Effect of exchange rate changes on cash and cash equivalents                               | 31,000                   | 59,000       |
| Net decrease in cash and cash equivalents                                                  | (989,000)                | (840,000)    |
| Cash and cash equivalents at beginning of year                                             | 9,834,000                | 10,674,000   |
| Cash and cash equivalents at end of year                                                   | \$ 8,845,000             | \$ 9,834,000 |



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## BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF EQUITY

Years ended September 30, 2011 and 2012

|                                                                                                                         | Shares<br>Outstanding | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Treasury<br>Stock | Non-controlling<br>Interests | Total<br>Equity |
|-------------------------------------------------------------------------------------------------------------------------|-----------------------|-----------------|----------------------------------|----------------------|-------------------------------------------------|-------------------|------------------------------|-----------------|
| <b>Balance at<br/>September 30, 2010</b>                                                                                | 8,277,160             | \$ 4,223,000    | \$ 1,289,000                     | \$ 34,340,000        | \$ 49,000                                       | \$ (2,286,000)    | \$ 993,000                   | \$ 38,608,000   |
| Contributions from<br>non-controlling<br>interests                                                                      |                       |                 |                                  |                      |                                                 |                   | 400,000                      | 400,000         |
| Distributions to<br>non-controlling<br>interests                                                                        |                       |                 |                                  |                      |                                                 |                   | (740,000)                    | (740,000)       |
| Net earnings (loss)                                                                                                     |                       |                 |                                  | (109,000)            |                                                 |                   | 314,000                      | 205,000         |
| Foreign currency<br>translation<br>adjustments, net of<br>taxes of \$0                                                  |                       |                 |                                  |                      | (446,000)                                       |                   |                              | (446,000)       |
| Retirement plans:                                                                                                       |                       |                 |                                  |                      |                                                 |                   |                              |                 |
| Amortization of<br>accumulated other<br>comprehensive loss<br>into net periodic<br>benefit cost, net of<br>taxes of \$0 |                       |                 |                                  |                      | 239,000                                         |                   |                              | 239,000         |
| Net actuarial gains<br>arising during the<br>period, net of taxes of<br>\$0                                             |                       |                 |                                  |                      | 448,000                                         |                   |                              | 448,000         |
| <b>Balance at<br/>September 30, 2011</b>                                                                                | 8,277,160             | 4,223,000       | 1,289,000                        | 34,231,000           | 290,000                                         | (2,286,000)       | 967,000                      | 38,714,000      |
| Contributions from<br>non-controlling<br>interests                                                                      |                       |                 |                                  |                      |                                                 |                   | 370,000                      | 370,000         |

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|                                                                                                                            |                  |                     |                     |                      |                     |                       |                   |                      |
|----------------------------------------------------------------------------------------------------------------------------|------------------|---------------------|---------------------|----------------------|---------------------|-----------------------|-------------------|----------------------|
| Distributions to non-controlling interests                                                                                 |                  |                     |                     |                      |                     |                       | (29,000)          | (29,000)             |
| Net loss                                                                                                                   |                  |                     |                     | (10,136,000)         |                     |                       | (826,000)         | (10,962,000)         |
| Foreign currency translation adjustments, net of taxes of \$0                                                              |                  |                     |                     |                      | 1,927,000           |                       |                   | 1,927,000            |
| Retirement plans: Amortization of accumulated other comprehensive loss into net periodic benefit cost, net of taxes of \$0 |                  |                     |                     |                      | 258,000             |                       |                   | 258,000              |
| Net actuarial losses arising during the period, net of taxes of \$0                                                        |                  |                     |                     |                      | (153,000)           |                       |                   | (153,000)            |
| <b>Balance at September 30, 2012</b>                                                                                       | <b>8,277,160</b> | <b>\$ 4,223,000</b> | <b>\$ 1,289,000</b> | <b>\$ 24,095,000</b> | <b>\$ 2,322,000</b> | <b>\$ (2,286,000)</b> | <b>\$ 482,000</b> | <b>\$ 30,125,000</b> |

See Notes to Consolidated Financial Statements

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**BARNWELL INDUSTRIES, INC.**

**AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**YEARS ENDED SEPTEMBER 30, 2012 AND 2011**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Description of Business*

Barnwell is engaged in the following lines of business: 1) exploring for, developing, producing and selling oil and natural gas in Canada, 2) investing in land interests in Hawaii, 3) drilling wells and installing and repairing water pumping systems in Hawaii, and 4) developing homes for sale in Hawaii.

*Principles of Consolidation*

The consolidated financial statements include the accounts of Barnwell Industries, Inc. and all majority-owned subsidiaries (collectively referred to herein as Barnwell, we, our, us, or the Company ), including a 77.6%-owned investment general partnership (Kaupulehu Developments) and two 80%-owned joint ventures (Kaupulehu 2007, LLLP and Kaupulehu Investors, LLC). Barnwell also has a 50% interest in a currently inactive and insignificant entity which Barnwell has the ability to exercise significant influence, but not control, and which is accounted for using the equity method. Kaupulehu Investors, LLC owns 1.5% passive minority interests in various joint ventures and accounts for these passive investments under the cost method. All significant intercompany accounts and transactions have been eliminated.

*Use of Estimates in the Preparation of Financial Statements*

The preparation of the financial statements in conformity with U.S. GAAP 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 assumptions are required in the valuation of deferred tax assets, asset retirement obligations, share-based payment arrangements, obligations for retirement plans, contract drilling estimated costs to complete, proved oil and natural gas reserves, and the carrying value of other assets, and such assumptions may impact the amount at which such items are recorded.

#### *Cash and Cash Equivalents*

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

#### *Accounts Receivable*

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is Barnwell's best estimate of the amount of probable credit losses in Barnwell's existing accounts receivable and is based on historical write-off experience and the application of the specific identification method. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. Barnwell does not have any off-balance sheet credit exposure related to its customers.

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*Real Estate Held for Sale*

The costs of acquiring land and costs related to development and construction, including interest, property taxes and general and administrative expenses related to the development of land and home construction, are capitalized. Costs that relate to a specific lot or home are assigned to that lot or home while common costs related to multiple lots or homes will be allocated to each in proportion to their anticipated sales value.

Real estate held for sale is reported at the lower of the asset carrying value or fair value less costs to sell. The recorded balances are evaluated for impairment whenever events or changes in circumstances indicate that the balance may not be fully recoverable. This evaluation requires management to make assumptions and apply considerable judgments to, among others, estimates of the timing and amount of future cash flows, uncertainty about future events, including changes in economic conditions, changes in operating performance, and ongoing cost of maintenance and improvements of the assets. Changes in these and other assumptions may require impairment charges that may materially impact the Company's financial condition or its future operating results. If economic conditions worsen in the future or if difficult market conditions extend beyond the Company's expectations resulting in a decrease in the fair value of the aforementioned assets below carrying value, the Company will be required to record an impairment loss.

Homebuilding revenue and related profit or loss are generally recognized at the time of the closing of a sale, when title to and possession of the property are transferred to the buyer.

*Investment in Residential Parcels*

Barnwell's investment in residential parcels consists of land held for speculative purposes which is not expected to be sold within a year of the balance sheet date.

Investment in residential parcels is reported at the lower of the asset carrying value or fair value less costs to sell. The recorded balances are evaluated for impairment whenever events or changes in circumstances indicate that the balance may not be fully recoverable. This evaluation requires management to make assumptions and apply considerable judgments to, among others, estimates of the timing and amount of future cash flows, uncertainty about future events, including changes in economic conditions, changes in operating performance, changes in the use of the assets, and ongoing cost of maintenance and improvements of the assets. Changes in these and other assumptions may require impairment charges that may materially impact the Company's financial condition or its future operating results. If economic conditions worsen in the future or if difficult market conditions extend beyond the Company's expectations resulting in a decrease in the fair value of the aforementioned assets below carrying value, the Company will be

required to record an impairment loss.

*Investment in Joint Ventures*

Barnwell accounts for its passive investments in joint ventures under the cost method as Barnwell's ownership interests are so minor that Barnwell has no influence over the operations and financial policies of the investee.

Passive joint venture investments are reviewed for impairment whenever factors indicate a decrease in value of the investment has occurred that is other-than-temporary. In evaluating whether an impairment is other-than-temporary, the Company considers all available information, including the length of time and extent of the impairment, the financial condition and near-term prospects of the affiliate, the Company's ability and intent to hold the investment for a period of time sufficient to allow

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for any anticipated recovery in market value, and projected industry and economic trends, among others. In determining the fair value of an investment and assessing whether any identified impairment is other-than-temporary, significant estimates and considerable judgment are involved. These estimates and judgments are based in part on the Company's current and future evaluation of economic conditions in general, as well as a joint venture's representations regarding current and future plans. These impairment calculations contain additional uncertainties because they also require management to make assumptions and apply judgments to, among others, estimates of future cash flows, probabilities related to various cash flow scenarios, and appropriate discount rates.

*Investment in Land Interests*

Barnwell accounts for Increment I and Increment II leasehold land interest sales under the full accrual method. Gains from such sales are recognized when the buyer's investments are adequate to demonstrate a commitment to pay for the property, risks and rewards of ownership have been transferred to the buyer, and Barnwell does not have a substantial continuing involvement with the property sold. With regard to the sales of Increment I and Increment II leasehold land interests, the percentage of sales payments are contingent future profits which will be recognized when they are realized. All costs of the sales of Increment I and Increment II leasehold land interests were recognized at the time of sale and none were deferred to future periods when any contingent profits will be recognized. Costs incurred for the acquisition and improvement of leasehold land interests and lot acquisition rights not yet sold are included in the Consolidated Balance Sheets under the caption Investments.

Investment in land interests is reported at the lower of the asset carrying value or fair value and is evaluated for impairment whenever events or changes in circumstances indicate that the recorded investment balance may not be fully recoverable. This evaluation requires management to make assumptions and apply considerable judgments to, among others, estimates of the timing and amount of future cash flows, uncertainty about future events, including changes in economic conditions, changes in operating performance, changes in the use of the assets, and ongoing cost of maintenance and improvements of the assets. Changes in these and other assumptions may require valuation adjustments that may materially impact the Company's financial condition or its future operating results. If economic conditions worsen in the future or if difficult market conditions extend beyond the Company's expectations resulting in a decrease in the fair value of the aforementioned assets below carrying value, the Company will be required to record an impairment loss.

*Oil and Natural Gas Properties*

Barnwell uses the full cost method of accounting under which all costs incurred in the acquisition, exploration and development of oil and natural gas reserves, including costs related to unsuccessful wells and estimated future site restoration and abandonment, are capitalized. We capitalize internal costs that can be directly identified with our

acquisition, exploration and development activities and do not include any costs related to production, general corporate overhead or similar activities.

Under the full cost method of accounting, we review the carrying value of our oil and natural gas properties, on a country-by-country basis, each quarter in what is commonly referred to as the ceiling test. Under the ceiling test, capitalized costs, net of accumulated depletion and oil and natural gas related deferred income taxes, may not exceed an amount equal to the sum of 1) the discounted present value (at 10%), using average first-day-of-the-month prices during the 12-month period ending in the reporting period on a constant basis, of Barnwell's estimated future net cash flows from estimated production of proved oil and natural gas reserves as determined by independent petroleum reserve engineers, less estimated future expenditures to be incurred in developing and producing the proved

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reserves but excluding future cash outflows associated with settling asset retirement obligations accrued on the balance sheet; plus 2) the cost of major development projects and unproven properties not subject to depletion, if any; plus 3) the lower of cost or estimated fair value of unproven properties included in costs subject to depletion; less 4) related income tax effects. If net capitalized costs exceed this limit, the excess is expensed. Depletion is computed using the units-of-production method whereby capitalized costs, net of estimated salvage values, plus estimated future costs to develop proved reserves and satisfy asset retirement obligations, are amortized over the total estimated proved reserves on a country-by-country basis. Investments in major development projects are not depleted until either proved reserves are associated with the projects or impairment has been determined. At September 30, 2012 and 2011, Barnwell had no investments in oil and natural gas development projects, proved or unproved, that were not being depleted. Proceeds from the disposition of minor producing oil and natural gas properties are credited to the cost of oil and natural gas properties. Gains or losses are recognized on the disposition of significant oil and natural gas properties.

Revenues associated with the sale of oil, natural gas and natural gas liquids are recognized in the Consolidated Statements of Operations when the oil, natural gas and natural gas liquids are delivered and title has passed to the customer.

Barnwell's sales reflect its working interest share after royalties. Barnwell's production is generally delivered and sold at the plant gate. Barnwell does not have transportation contracts with pipelines and does not have natural gas imbalances related to natural gas balancing arrangements with its partners.

*Long-lived Assets*

Long-lived assets to be held and used, other than oil and natural gas properties, are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. If the future cash flows expected to result from use of the asset (undiscounted and without interest charges) are less than the carrying amount of the asset, an impairment loss is recognized. Such impairment loss is measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of the asset carrying value or fair value, less cost to sell.

Drilling rigs, office and other property and equipment are depreciated using the straight-line method based on estimated useful lives.

*Share-based Compensation*

Share-based compensation cost is measured at fair value. Barnwell utilizes a closed-form valuation model to determine the fair value of each option award. Expected volatilities are based on the historical volatility of Barnwell's stock over a period consistent with that of the expected terms of the options. The expected terms of the options represent expectations of future employee exercise and are estimated based on factors such as vesting periods, contractual expiration dates, historical trends in Barnwell's stock price, and historical exercise behavior. The risk-free rates for periods within the contractual life of the options are based on the yields of U.S. Treasury instruments with terms comparable to the estimated option terms. Expected dividends are based on current and historical dividend payments.

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*Retirement Plans*

Barnwell accounts for its defined benefit pension plan, Supplemental Employee Retirement Plan, and postretirement medical insurance benefits plan by recognizing the over-funded or under-funded status of defined benefit pension and other postretirement plans (other than a multiemployer plan) as an asset or liability in its Consolidated Balance Sheet and recognizes changes in that funded status in the year in which the changes occur through comprehensive income. See further discussion at Note 10 below.

The estimation of Barnwell's retirement plan obligations, costs and liabilities requires management to estimate the amount and timing of cash outflows for projected future payments and cash inflows for maturities and expected returns on plan assets. These assumptions may have an effect on the amount and timing of future contributions.

At the end of each year, Barnwell determines the discount rate to be used to calculate the present value of plan liabilities and the net periodic benefit cost. The discount rate is an estimate of the current interest rate at which the retirement plan liabilities could be effectively settled at the end of the year. In estimating this rate, Barnwell looks to rates of return on high-quality, fixed-income investments and references the Citigroup Pension Liability Index at our balance sheet date. The discount rate used to value the future benefit obligation as of each year-end is the rate used to determine the periodic benefit cost in the following year. The estimated rate of return on plan assets is based on historical trends combined with long-term expectations, the mix of plan assets and long-term inflation assumptions.

The effects of actual results differing from the above assumptions or revisions to actuarial assumptions could materially affect Barnwell's financial condition and/or results of operations. The effects of changing assumptions are included in unamortized net gains and losses, which directly affect accumulated other comprehensive income. These unamortized gains and losses are amortized and reclassified to (loss) income over future periods.

*Asset Retirement Obligation*

Barnwell accounts for asset retirement obligations by recognizing the fair value of a liability for an asset retirement obligation in the period in which it is incurred. 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. When the assumptions used to estimate a recorded asset retirement obligation change, a revision is recorded to both the asset retirement obligation and the capitalized cost of asset retirements. The liability is accreted at the end of each period through charges to oil and natural gas operating expense.

*Income Taxes*

Income taxes are determined using the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax impacts of differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

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Management evaluates its potential exposures from tax positions taken that have been or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statutes, regulations and rules. Management considers the possibility of alternative outcomes based upon past experience, previous actions by taxing authorities (e.g., actions taken in other jurisdictions) and advice from tax experts. 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 on a jurisdiction-by-jurisdiction basis. Liabilities for unrecognized tax benefits related to such tax positions are included in long-term liabilities unless the tax position is expected to be settled within the upcoming year, in which case the liabilities are included in current liabilities. Interest and penalties related to uncertain tax positions are included in income tax expense.

*Contract Drilling*

Revenues, costs and profits applicable to contract drilling contracts are included in the Consolidated Statements of Operations using the percentage of completion method, principally measured by the percentage of labor dollars incurred to date for each contract to total estimated labor dollars for each contract. Contract losses are recognized in full in the period the losses are identified. The performance of drilling contracts may extend over more than a year and, in the interim periods, estimates of total contract costs and profits are used to determine revenues and profits earned for reporting the results of contract drilling operations. Revisions in the estimates required by subsequent performance and final contract settlements are included as adjustments to the results of operations in the period such revisions and settlements occur. Contracts are normally less than a year in duration.

*Environmental*

Barnwell is subject to extensive environmental laws and regulations. These laws, which are constantly changing, regulate the discharge of materials into the environment and maintenance of surface conditions and may require Barnwell to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites. Environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no future economic benefit are expensed. Liabilities for expenditures of a noncapital nature are recorded when environmental assessment and/or remediation is probable, and the costs can be reasonably estimated.

*Foreign Currency Translation*

Assets and liabilities of foreign subsidiaries are translated at the year-end exchange rate and resulting translation gains or losses are accounted for in an equity account entitled Accumulated other comprehensive income, net. Operating results of foreign subsidiaries are translated at average exchange rates during the period. Realized foreign currency transaction gains or losses were inconsequential in fiscal 2012 and 2011.

#### *Fair Value Measurements*

Fair value is defined as the amount that would be received from the sale of an asset or paid for the transfer of a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are classified and disclosed in one of the following categories:

- Level 1: Unadjusted quoted prices in active markets for identical assets and liabilities in active markets and have the highest priority.

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- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: Unobservable inputs for the financial asset or liability and have the lowest priority.

*Recent Accounting Pronouncements*

In May 2011, the FASB issued an accounting standards update that provides a uniform framework for fair value measurements and related disclosures between GAAP and International Financial Reporting Standards. The amendments clarify or change the application of existing fair value measurements, including: (1) that the highest and best use and valuation premise in a fair value measurement are relevant only when measuring the fair value of nonfinancial assets; (2) that a reporting entity should measure the fair value of its own equity instrument from the perspective of a market participant that holds that instrument as an asset; (3) for Level 3 fair value measurements, quantitative information about the unobservable inputs used in a fair value measurement, a description of the valuation processes used by the entity, and a discussion about the sensitivity of the fair value measurements to changes in the unobservable inputs should be disclosed; (4) to permit an entity to measure the fair value of certain financial instruments on a net basis rather than based on its gross exposure when the reporting entity manages its financial instruments on the basis of such net exposure; (5) that in the absence of a Level 1 input, a reporting entity should apply premiums or discounts when market participants would do so when pricing the asset or liability consistent with the unit of account; (6) that premiums and discounts related to size as a characteristic of the reporting entity's holding are not permitted in a fair value measurement; (7) for an entity's use of a nonfinancial asset that is different from the asset's highest and best use, the reason for the difference; and (8) for financial instruments not measured at fair value but for which disclosure of fair value is required, the fair value hierarchy level in which the fair value measurements were determined. The Company adopted the provisions of the accounting standards update effective January 1, 2012. The adoption of this accounting standards update did not have a material impact on our consolidated financial statements.

**2. LOSS PER COMMON SHARE**

Basic loss per share excludes dilution and is computed by dividing net loss attributable to Barnwell stockholders by the weighted-average number of common shares outstanding for the period. Diluted loss per share includes the potentially dilutive effect of outstanding common stock options.

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Reconciliations between net loss attributable to Barnwell stockholders and common shares outstanding of the basic and diluted net loss per share computations are detailed in the following tables:

|                                                         | Year ended September 30, 2012 |                         |                     |
|---------------------------------------------------------|-------------------------------|-------------------------|---------------------|
|                                                         | Net Loss<br>(Numerator)       | Shares<br>(Denominator) | Per-Share<br>Amount |
| Basic net loss per share                                | \$ (10,136,000)               | 8,277,160               | \$ (1.22)           |
| Effect of dilutive securities -<br>common stock options | -                             | -                       |                     |
| Diluted net loss per share                              | \$ (10,136,000)               | 8,277,160               | \$ (1.22)           |

|                                                         | Year ended September 30, 2011 |                         |                     |
|---------------------------------------------------------|-------------------------------|-------------------------|---------------------|
|                                                         | Net Loss<br>(Numerator)       | Shares<br>(Denominator) | Per-Share<br>Amount |
| Basic net loss per share                                | \$ (109,000)                  | 8,277,160               | \$ (0.01)           |
| Effect of dilutive securities -<br>common stock options | -                             | -                       |                     |
| Diluted net loss per share                              | \$ (109,000)                  | 8,277,160               | \$ (0.01)           |

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Potentially dilutive shares consist of the common shares issuable upon the exercise of outstanding stock options (both vested and non-vested) using the treasury stock method. Potentially dilutive shares are excluded from the computation of loss per share if their effect is antidilutive. Options to purchase 815,375 shares of common stock were excluded from the computation of diluted shares for fiscal years 2012 and 2011 as their inclusion would have been antidilutive.

### 3. **SHARE-BASED PAYMENTS**

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

|                                            | Year ended September 30, |            |
|--------------------------------------------|--------------------------|------------|
|                                            | 2012                     | 2011       |
| Share-based compensation (benefit) expense | \$ (103,000)             | \$ 404,000 |
| Income tax effect                          | \$ -                     | \$ -       |

Share-based compensation (benefit) expense recognized in losses for the years ended September 30, 2012 and 2011 are reflected in General and administrative expenses in the Consolidated Statements of Operations. There was no impact on income taxes for the years ended September 30, 2012 and 2011 due to a full valuation allowance on the related deferred tax asset.

#### *Description of Share-Based Payment Arrangements*

The Company's stock option plans are administered by the Compensation Committee of the Board of Directors.

*1998 Stock Option Plan:* Under the stockholder-approved 1998 Stock Option Plan, Barnwell was authorized to grant up to 780,000 shares of common stock to employees. Option shares are no longer available for grant. Stock options grants include qualified options that have an exercise price equal to the closing market price of Barnwell's stock on the date preceding the date of grant (110% of the closing market price on the date preceding the date of grant for options granted to affiliates), vest annually over four years of continuous service, and expire ten years from the date of grant (five years from date of grant for options granted to affiliates).

*Non-qualified stock options:* In December 2004, Barnwell granted non-qualified options with an exercise price equal to the closing market price of Barnwell's stock on the date of grant, that vest annually over five years of continuous service, and that expire ten years from the date of grant. The non-qualified options have stock appreciation rights features that permit the holder to receive stock, cash or a combination thereof equal to the amount by which the fair market value, at the time of exercise of the option, exceeds the option price.

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*2008 Equity Incentive Plan:* The stockholder-approved 2008 Equity Incentive Plan provides for the issuance of incentive stock options, nonstatutory stock options, stock options with stock appreciation rights, restricted stock, restricted stock units and performance units, qualified performance-based awards, and stock grants to employees, consultants and non-employee members of the Board of Directors. 800,000 shares of Barnwell common stock have been reserved for issuance and as of September 30, 2012, a total of 122,500 share options remain available for grant. Stock options grants include nonqualified stock options that have exercise prices equal to Barnwell's stock price on the date of grant, vest annually over a service period of four years commencing one year from the date of grant and expire ten years from the date of grant. The options have stock appreciation rights that permit the holder to receive stock, cash or a combination thereof equal to the amount by which the fair market value, at the time of exercise of the option, exceeds the option price.

Barnwell currently has a policy of issuing new shares to satisfy share option exercises under both the qualified plans and non-qualified plans when the optionee requests shares.

*Equity-classified Awards*

Compensation cost for equity-classified awards is measured at the grant date based on the fair value of the award and is recognized as an expense over the requisite service period.

A summary of the activity in Barnwell's equity-classified share options from October 1, 2011 through September 30, 2012 is presented below:

| Options                           | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value |
|-----------------------------------|--------|---------------------------------|---------------------------------------------|---------------------------|
| Outstanding at October 1, 2011    | 60,000 | \$ 8.62                         |                                             |                           |
| Granted                           | -      |                                 |                                             |                           |
| Exercised                         | -      |                                 |                                             |                           |
| Expired/Forfeited                 | -      |                                 |                                             |                           |
| Outstanding at September 30, 2012 | 60,000 | \$ 8.62                         | 2.2                                         | \$ -                      |
| Exercisable at September 30, 2012 | 60,000 | \$ 8.62                         | 2.2                                         | \$ -                      |

There was no share-based compensation expense for equity-classified awards in the years ended September 30, 2012 and 2011.

No equity options were exercised during the years ended September 30, 2012 and 2011.

*Liability-classified Awards*

Compensation cost for liability-classified awards is remeasured at each period-end using a closed-form valuation model based on current values and is recognized as an expense over the requisite service period.

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As of September 30, 2012, there was \$52,000 of total unrecognized compensation cost related to nonvested liability-classified share options. That cost is expected to be recognized over 1.2 years.

The following assumptions were used in estimating fair value for all liability-classified share options outstanding:

|                             | Year ended September 30, |                |
|-----------------------------|--------------------------|----------------|
|                             | 2012                     | 2011           |
| Expected volatility range   | 59.2% to 66.8%           | 56.5% to 71.0% |
| Weighted-average volatility | 62.2%                    | 63.1%          |
| Expected dividends          | 0.0%                     | 0.0%           |
| Expected term (in years)    | 2.2 to 7.2               | 3.2 to 8.2     |
| Risk-free interest rate     | 0.2% to 1.0%             | 0.4% to 1.7%   |
| 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 Consolidated Statements of Operations.

A summary of the activity in Barnwell's liability-classified share options from October 1, 2011 through September 30, 2012 is presented below:

| Options                           | Shares  | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value |
|-----------------------------------|---------|---------------------------------|---------------------------------------------|---------------------------|
| Outstanding at October 1, 2011    | 755,375 | \$ 8.40                         |                                             |                           |
| Granted                           | -       |                                 |                                             |                           |
| Exercised                         | -       |                                 |                                             |                           |
| Expired/Forfeited                 | -       |                                 |                                             |                           |
| Outstanding at September 30, 2012 | 755,375 | \$ 8.40                         | 5.4                                         | \$ -                      |
| Exercisable at September 30, 2012 | 591,625 | \$ 9.53                         | 5.0                                         | \$ -                      |

The following table summarizes the components of the total share-based compensation for liability-classified awards:

|                                                                             | Year ended September 30, |            |
|-----------------------------------------------------------------------------|--------------------------|------------|
|                                                                             | <b>2012</b>              | 2011       |
| Due to vesting                                                              | \$ <b>105,000</b>        | \$ 253,000 |
| Due to remeasurement                                                        | <b>(208,000)</b>         | 151,000    |
| Total share-based compensation (benefit) expense for liability-based awards | \$ <b>(103,000)</b>      | \$ 404,000 |

No liability-classified options were exercised during the year ended September 30, 2012. During the year ended September 30, 2011, the cash feature of 43,125 shares of non-qualified options was exercised. The total intrinsic value of the liability-classified options exercised during fiscal 2011 was \$130,000. There is no estimated tax benefit related to the options exercised during the year ended September 30, 2011 due to a full valuation allowance on the related deferred tax asset.

Table of Contents**4. ACCOUNTS RECEIVABLE AND CONTRACT COSTS**

Accounts receivable are net of allowances for doubtful accounts of \$45,000 and \$70,000 as of September 30, 2012 and 2011, respectively. Included in accounts receivable are contract retainage balances of \$307,000 and \$324,000 as of September 30, 2012 and 2011, respectively. The retainage balance as of September 30, 2012 is expected to be collected within one year, generally within 45 days after the related contracts have received final acceptance and approval.

Costs and estimated (loss) earnings on uncompleted contracts are as follows:

|                                         | September 30, |              |
|-----------------------------------------|---------------|--------------|
|                                         | 2012          | 2011         |
| Costs incurred on uncompleted contracts | \$ 2,373,000  | \$ 1,315,000 |
| Estimated (loss) earnings               | (238,000)     | 169,000      |
|                                         | 2,135,000     | 1,484,000    |
| Less billings to date                   | 2,331,000     | 1,403,000    |
|                                         | \$ (196,000)  | \$ 81,000    |

Costs and estimated (loss) earnings on uncompleted contracts are included in the Consolidated Balance Sheets as follows:

|                                                                                                                     | September 30, |            |
|---------------------------------------------------------------------------------------------------------------------|---------------|------------|
|                                                                                                                     | 2012          | 2011       |
| Costs and estimated earnings in excess of billings on uncompleted contracts (included in other current assets)      | \$ 321,000    | \$ 444,000 |
| Billings in excess of costs and estimated earnings on uncompleted contracts (included in other current liabilities) | (517,000)     | (363,000)  |
|                                                                                                                     | \$ (196,000)  | \$ 81,000  |

**5. REAL ESTATE HELD FOR SALE**

Kaupulehu 2007 developed two luxury residences in the Lot 4A Increment I area located in the North Kona District of the island of Hawaii, north of Hualalai Resort at Historic Kaupulehu, between the Queen Kaahumanu Highway and the Pacific Ocean.

During the quarter ended June 30, 2012, one of the homes developed by Kaupulehu 2007 was sold for \$5,975,000 for a nominal loss.

During the quarter ended March 31, 2012, Kaupulehu 2007 recorded a \$1,854,000 reduction in the carrying values of both houses held for sale to reflect a decline in the estimated market value of the two luxury residences. The writedown is included in the Consolidated Statements of Operations under the caption Reduction of carrying value of assets.

Table of Contents**6. INVESTMENTS**

A summary of Barnwell's investments is as follows:

|                                          | 2012         | September 30,<br>2011 |
|------------------------------------------|--------------|-----------------------|
| Investment in two residential parcels    | \$ 2,331,000 | \$ 2,331,000          |
| Investment in joint ventures             | -            | 1,754,000             |
| Investment in land interests:            |              |                       |
| Leasehold land zoned conservation Lot 4C | 50,000       | 50,000                |
| Lot acquisition rights Mauka Lands       | -            | 488,000               |
| Total investments                        | \$ 2,381,000 | \$ 4,623,000          |

*Investment in two residential parcels*

Kaupulehu 2007 owns two residential parcels in the Lot 4A Increment I area located in the North Kona District of the island of Hawaii, north of Hualalai Resort at Historic Kaupulehu, between the Queen Kaahumanu Highway and the Pacific Ocean.

During the year ended September 30, 2011, Kaupulehu 2007 recorded a \$689,000 reduction of the carrying value of its investment in residential parcels as a result of changes in fair values for real estate in the Lot 4A Increment I area of Kaupulehu, North Kona, Hawaii. The writedown is included in the Consolidated Statements of Operations under the caption Reduction of carrying value of assets. No reduction was necessary during the year ended September 30, 2012.

*Investment in joint ventures*

Kaupulehu Investors, LLC owns passive minority interests in Hualalai Investors JV, LLC and Hualalai Investors II, LLC (hereinafter collectively referred to as Hualalai Investors), owners of Hualalai Resort, and a passive minority interest in Kona Village Investors, LLC, owner of Kona Village Resort. Kaupulehu Investors, LLC accounts for these passive investments under the cost method.

Due to recent uncertainty regarding the financial condition of the joint venture entities in which the Company has passive interests and the duration of current economic conditions and the corresponding impact of such conditions on the Company's ability to recover its investment within the Company's currently estimated holding period, the Company wrote off its remaining \$1,754,000 investment in joint ventures in fiscal 2012 as management has concluded that there has been an other-than-temporary impairment of these investments. The write-off is included in the Consolidated Statements of Operations under the caption Reduction of carrying value of assets.

Kona Village Resort sustained considerable damage as a result of the March 2011 tsunami and subsequently shut down indefinitely. As such, Barnwell wrote-off its remaining investment in Kona Village Investors, LLC of \$121,000 during the year ended September 30, 2011. The writedown is included in the Consolidated Statements of Operations under the caption Reduction of carrying value of assets.

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Kaupulehu Developments received its final development rights option payment in December 2010. Revenues related to sales of development rights under option are summarized as follows:

|                                          | Year ended September 30, |              |
|------------------------------------------|--------------------------|--------------|
|                                          | 2012                     | 2011         |
| Sale of development rights under option: |                          |              |
| Proceeds                                 | \$ -                     | \$ 2,656,000 |
| Fees                                     | -                        | (159,000)    |
| Revenues sale of development rights, net | \$ -                     | \$ 2,497,000 |

*Percentage of Sales Payments*

Kaupulehu Developments has the right to receive payments from WB and WBKD, entities not affiliated with Barnwell and its subsidiaries, resulting from the sale of lots and/or residential units within approximately 870 acres of the Kaupulehu Lot 4A area by WB and WBKD in two increments ( Increment I and Increment II ).

With respect to Increment I, Kaupulehu Developments is entitled to receive payments from WB based on the following percentages of the gross receipts from WB's sales of single-family residential lots in Increment I: 9% of the gross proceeds from single-family lot sales up to aggregate gross proceeds of \$100,000,000; 10% of such aggregate gross proceeds greater than \$100,000,000 up to \$300,000,000; and 14% of such aggregate gross proceeds in excess of \$300,000,000.

The following table summarizes the Increment I percentage of sales payment revenues received from WB:

|                                                  | Year ended September 30, |              |
|--------------------------------------------------|--------------------------|--------------|
|                                                  | 2012                     | 2011         |
| Sale of interest in leasehold land:              |                          |              |
| Proceeds                                         | \$ 512,000               | \$ 1,325,000 |
| Fees                                             | (30,000)                 | (80,000)     |
| Revenues sale of interest in leasehold land, net | \$ 482,000               | \$ 1,245,000 |

As of September 30, 2012, 31 of the 80 single-family lots planned in Increment I have been sold by WB.

With respect to Increment II, which is not yet developed, Kaupulehu Developments is entitled to receive future payments from WBKD based on a percentage of the sales prices of the residential lots or units, as well as additional payments after the members of WBKD have received distributions equal to the capital they invested in the project.

There is no assurance with regards to the amounts of future payments to be received.

*Lot 4C*

Kaupulehu Developments holds an interest in Lot 4C, an area of approximately 1,000 acres of vacant leasehold land zoned conservation located adjacent to Lot 4A. WB and/or WBKD have the exclusive right to negotiate with Kaupulehu Developments with respect to Lot 4C until June 2013 unless extended by Barnwell.

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There is no assurance that the required land use reclassification and rezoning from regulatory agencies will be obtained, that the necessary development terms and agreements will be successfully negotiated for Lot 4C, or that WB and/or WBKD will enter into an agreement with Kaupulehu Developments regarding Lot 4C.

*Lot acquisition rights*

Barnwell, through wholly-owned Kaupulehu Mauka Investors, LLC, owns acquisition rights as to 14 lots within agricultural-zoned leasehold land in the upland area of Kaupulehu ( Mauka Lands ) situated between the Queen Kaahumanu Highway and the Mamalahoa Highway at Kaupulehu, on the island of Hawaii. The acquisition rights give Barnwell the right to acquire the aforementioned residential lots, currently estimated to be two to five acres in size, which may be developed on the Mauka Lands. These lands are currently classified as agricultural by the state of Hawaii and, accordingly, the developer of these lands (Hualalai Investors) will need to pursue both state and county of Hawaii approvals for reclassification and rezoning to permit the development of residential lots and negotiate development terms.

Due to recent heightened uncertainty regarding the likelihood of development of the Mauka Lands, and accordingly, the corresponding impact of such conditions on the Company's ability to recover its investment in lot acquisition rights, the Company wrote off its remaining \$488,000 investment in lot acquisition rights in fiscal 2012. The write-off is included in the Consolidated Statements of Operations under the caption Reduction of carrying value of assets.

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

Barnwell's property and equipment is detailed as follows:

|                                                             | Estimated<br>Useful<br>Lives | Gross<br>Property and<br>Equipment | Accumulated<br>Depletion,<br>Depreciation,<br>and<br>Amortization | Net<br>Property and<br>Equipment |
|-------------------------------------------------------------|------------------------------|------------------------------------|-------------------------------------------------------------------|----------------------------------|
| <u>At September 30, 2012:</u>                               |                              |                                    |                                                                   |                                  |
| Land                                                        |                              | \$ 863,000                         | \$ -                                                              | \$ 863,000                       |
| Oil and natural gas<br>properties<br>(full cost accounting) |                              | 242,433,000                        | (198,768,000)                                                     | 43,665,000                       |

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|                              |            |                       |                         |                      |
|------------------------------|------------|-----------------------|-------------------------|----------------------|
| Drilling rigs and equipment  | 3 10 years | 6,752,000             | (5,152,000)             | 1,600,000            |
| Offices                      | 40 years   | 2,420,000             | (264,000)               | 2,156,000            |
| Other property and equipment | 3 17 years | 3,685,000             | (3,345,000)             | 340,000              |
| Total                        |            | <b>\$ 256,153,000</b> | <b>\$ (207,529,000)</b> | <b>\$ 48,624,000</b> |

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|                                                             | Estimated<br>Useful<br>Lives | Gross<br>Property and<br>Equipment | Accumulated<br>Depletion,<br>Depreciation,<br>and<br>Amortization | Net<br>Property and<br>Equipment |
|-------------------------------------------------------------|------------------------------|------------------------------------|-------------------------------------------------------------------|----------------------------------|
| <u>At September 30, 2011:</u>                               |                              |                                    |                                                                   |                                  |
| Land                                                        |                              | \$ 863,000                         | \$ -                                                              | \$ 863,000                       |
| Oil and natural gas<br>properties<br>(full cost accounting) |                              | 224,852,000                        | (175,715,000)                                                     | 49,137,000                       |
| Drilling rigs and<br>equipment                              | 3 10 years                   | 7,020,000                          | (4,988,000)                                                       | 2,032,000                        |
| Offices                                                     | 40 years                     | 2,420,000                          | (203,000)                                                         | 2,217,000                        |
| Other property and<br>equipment                             | 3 17 years                   | 3,881,000                          | (3,511,000)                                                       | 370,000                          |
| Total                                                       |                              | \$ 239,036,000                     | \$ (184,417,000)                                                  | \$ 54,619,000                    |

Under the full cost method of accounting, we are required to perform quarterly ceiling test calculations. Barnwell's net capitalized costs exceeded the ceiling limitation at September 30, 2012. As such, Barnwell reduced the carrying value of its oil and natural gas properties by \$2,551,000 during the year ended September 30, 2012. No such reduction was necessary during fiscal 2011. The reduction is included in the Consolidated Statements of Operations under the caption "Reduction of carrying value of assets."

Based on the impact of first-day-of-the-month oil, natural gas and natural gas liquids prices during the first quarter of fiscal 2013 on the 12-month average first-day-of-the-month trailing prices used in the calculation of the ceiling limitation, the Company may be required to record a reduction in carrying value of its oil and natural gas properties in its first quarter of fiscal 2013. The Company is unable to estimate a range of the amount of the potential reduction in carrying value as other variables that potentially impact the ceiling limitation are dependent upon results of activity during the first quarter of fiscal 2013, which is not yet complete as of the date of this filing.

Barnwell recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made. The following is a reconciliation of the asset retirement obligation:

|                                                     | Year ended September 30, |              |
|-----------------------------------------------------|--------------------------|--------------|
|                                                     | 2012                     | 2011         |
| Asset retirement obligation as of beginning of year | \$ 4,921,000             | \$ 4,869,000 |
| Obligations incurred on new wells drilled           | 68,000                   | 123,000      |

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|                                               |                     |                     |
|-----------------------------------------------|---------------------|---------------------|
| Revision of estimated obligation              | <b>320,000</b>      | (330,000)           |
| Accretion expense                             | <b>363,000</b>      | 341,000             |
| Payments                                      | <b>(324,000)</b>    | (36,000)            |
| Foreign currency translation adjustment       | <b>281,000</b>      | (46,000)            |
|                                               |                     |                     |
| Asset retirement obligation as of end of year | <b>\$ 5,629,000</b> | <b>\$ 4,921,000</b> |

Table of Contents**8. INCENTIVE COMPENSATION PLAN**

Barnwell established an incentive compensation plan in fiscal 2002 to compensate certain Canadian oil and natural gas segment personnel. The value of the plan is directly related to our oil and natural gas segment's net income and the value of our oil and natural gas reserves discovered for projects developed by such personnel. Barnwell recognized \$0 and \$41,000 of costs pursuant to this plan in fiscal 2012 and 2011, respectively. Amounts accrued under this plan totaled \$394,000 and \$681,000 as of September 30, 2012 and 2011, respectively, and are reported under the caption Accrued compensation on the Consolidated Balance Sheets.

**9. LONG-TERM DEBT**

A summary of Barnwell's long-term debt is as follows:

|                                    |                      | September 30, |              |
|------------------------------------|----------------------|---------------|--------------|
|                                    | <b>2012</b>          |               | <b>2011</b>  |
| Canadian revolving credit facility | \$ <b>12,000,000</b> | \$            | 12,000,000   |
| Real estate loan                   | <b>5,164,000</b>     |               | 11,714,000   |
|                                    | <b>17,164,000</b>    |               | 23,714,000   |
| Less current portion               | <b>(5,764,000)</b>   |               | (12,314,000) |
| Total long-term debt               | \$ <b>11,400,000</b> | \$            | 11,400,000   |

*Canadian revolving credit facility*

Barnwell has a credit facility at Royal Bank of Canada, a Canadian bank, for \$20,000,000 Canadian dollars, or US\$20,332,000 at the September 30, 2012 exchange rate. Unused credit available under this facility was US\$8,332,000 and the interest rate on the facility was 2.73% at September 30, 2012.

The facility is available in U.S. dollars at LIBOR plus 2.50%, at the Royal Bank U.S. base rate plus 1.50%, or in Canadian dollars at the Royal Bank prime rate plus 1.50%. A standby fee of 0.6250% per annum is charged on the

unused facility balance. Under the financing agreement with Royal Bank of Canada, the facility is reviewed annually, with the next review planned for April 2013. Subject to that review, the facility may be renewed for one year with no required debt repayments or converted to a two-year term loan by the bank. If the facility is converted to a two-year term loan, Barnwell has agreed to the following repayment schedule of the then outstanding loan balance: first year of the term period 20% (5% per quarter), and in the second year of the term period 80% (5% per quarter for the first three quarters and 65% in the final quarter). Based on the terms of this agreement, if Royal Bank of Canada were to convert the facility to a two-year term loan upon its next review in April 2013, Barnwell would be obligated to make quarterly principal repayments beginning in July 2013. As such, one quarterly repayment of 5% would be due within one year of September 30, 2012 and accordingly, we have included \$600,000 in the current portion of long-term debt.

Barnwell has the option to change the currency denomination and interest rate applicable to the loan at periodic intervals during the term of the loan. The facility is guaranteed by Barnwell and is collateralized by a general security agreement on all of the assets of Barnwell's oil and natural gas segment. No compensating bank balances are required for this facility.

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*Real estate loan*

Barnwell, together with its real estate joint venture, Kaupulehu 2007, has a non-revolving real estate loan with a Hawaii bank. As a result of the sale of one of its homes in June 2012, Kaupulehu 2007 repaid \$5,277,000 of the real estate loan in addition to the scheduled monthly payments. In September 2012, the loan was modified to reduce the monthly payments of principal and interest to \$58,000. The monthly payment will change as a result of an annual change in the interest rate, the sale of a house or the sale of a residential parcel. The interest rate adjusts each April for the remaining term of the loan to the lender's then prevailing interest rate for similarly priced commercial mortgage loans or a floating rate equal to the lender's base rate. The interest rate at September 30, 2012 was 3.57%. Any unpaid principal balance and accrued interest will be due and payable on April 1, 2018.

The loan is collateralized by, among other things, a first mortgage on Kaupulehu 2007's lots together with all improvements thereon. Kaupulehu 2007 will be required to make a principal payment upon the sale of a house or a residential parcel in the amount of the net sales proceeds of the house or residential parcel; the loan agreement defines net sales proceeds as the gross sales proceeds for the house or residential parcel, less reasonable commissions and normal closing costs.

The loan agreement contains provisions requiring us to maintain compliance with certain covenants including a consolidated debt service coverage ratio and a consolidated total liabilities to tangible net worth ratio. As of September 30, 2012, we were in compliance with the loan covenants.

The home collateralizing the loan is currently available for sale; therefore, the entire balance outstanding at September 30, 2012 under the term loan has been classified as a current liability.

*Combined Maturities*

Combined maturities of borrowings are as follows based on the assumption that Kaupulehu 2007's home is sold during fiscal 2013 and that Royal Bank of Canada does not renew our facility upon the next review in April 2013 and the facility is therefore converted to a term loan:

Fiscal year ending

|            |    |            |
|------------|----|------------|
| 2013       | \$ | 5,764,000  |
| 2014       |    | 2,400,000  |
| 2015       |    | 9,000,000  |
| 2016       |    | -          |
| 2017       |    | -          |
| Thereafter |    | -          |
| Total      | \$ | 17,164,000 |

# **10. RETIREMENT PLANS**

Barnwell sponsors a noncontributory defined benefit pension plan ( Pension Plan ) covering substantially all of its U.S. employees, with benefits based on years of service and the employee's highest consecutive five-year average earnings. Barnwell's funding policy is intended to provide for both benefits attributed to service to date and for those expected to be earned in the future. In addition, 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 U.S. employees who have attained at least 20 years of service with Barnwell and served at least 10 years at the position of Vice President or higher, their spouses and qualifying dependents.

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The following tables detail the changes in benefit obligations, fair values of plan assets and reconciliations of the funded status of the retirement plans:

|                                                | Pension        |                | SERP<br>September 30, |                | Postretirement Medical |                |
|------------------------------------------------|----------------|----------------|-----------------------|----------------|------------------------|----------------|
|                                                | 2012           | 2011           | 2012                  | 2011           | 2012                   | 2011           |
| <i>Change in Projected Benefit Obligation:</i> |                |                |                       |                |                        |                |
| Benefit obligation at beginning of year        | \$ 7,045,000   | \$ 6,959,000   | \$ 1,310,000          | \$ 1,195,000   | \$ 1,031,000           | \$ 1,365,000   |
| Service cost                                   | 302,000        | 298,000        | 50,000                | 45,000         | 12,000                 | 12,000         |
| Interest cost                                  | 323,000        | 311,000        | 61,000                | 58,000         | 49,000                 | 51,000         |
| Actuarial loss (gain)                          | 352,000        | (342,000)      | 97,000                | 18,000         | 150,000                | (397,000)      |
| Benefits paid                                  | (261,000)      | (174,000)      | (6,000)               | (6,000)        | -                      | -              |
| Administrative expenses paid                   | (8,000)        | (7,000)        | -                     | -              | -                      | -              |
| Benefit obligation at end of year              | 7,753,000      | 7,045,000      | 1,512,000             | 1,310,000      | 1,242,000              | 1,031,000      |
| <i>Change in Plan Assets:</i>                  |                |                |                       |                |                        |                |
| Fair value of plan assets at beginning of year | 4,214,000      | 4,123,000      | -                     | -              | -                      | -              |
| Actual return on plan assets                   | 773,000        | 22,000         | -                     | -              | -                      | -              |
| Employer contributions                         | 670,000        | 250,000        | 6,000                 | 6,000          | -                      | -              |
| Benefits paid                                  | (261,000)      | (174,000)      | (6,000)               | (6,000)        | -                      | -              |
| Administrative expenses paid                   | (8,000)        | (7,000)        | -                     | -              | -                      | -              |
| Fair value of plan assets at end of year       | 5,388,000      | 4,214,000      | -                     | -              | -                      | -              |
| Funded status                                  | \$ (2,365,000) | \$ (2,831,000) | \$ (1,512,000)        | \$ (1,310,000) | \$ (1,242,000)         | \$ (1,031,000) |

|                                                               | Pension        |                | SERP<br>September 30, |                | Postretirement Medical |                |
|---------------------------------------------------------------|----------------|----------------|-----------------------|----------------|------------------------|----------------|
|                                                               | 2012           | 2011           | 2012                  | 2011           | 2012                   | 2011           |
| <i>Amounts recognized in the Consolidated Balance Sheets:</i> |                |                |                       |                |                        |                |
| Noncurrent assets                                             | \$ -           | \$ -           | \$ -                  | \$ -           | \$ -                   | \$ -           |
| Current liabilities                                           | -              | -              | (5,000)               | (5,000)        | -                      | -              |
| Noncurrent liabilities                                        | (2,365,000)    | (2,831,000)    | (1,507,000)           | (1,305,000)    | (1,242,000)            | (1,031,000)    |
| Net amount                                                    | \$ (2,365,000) | \$ (2,831,000) | \$ (1,512,000)        | \$ (1,310,000) | \$ (1,242,000)         | \$ (1,031,000) |

*Amounts recognized in accumulated other comprehensive income:*

|                                      |              |              |            |            |             |              |
|--------------------------------------|--------------|--------------|------------|------------|-------------|--------------|
| Net actuarial loss (gain)            | \$ 2,559,000 | \$ 2,765,000 | \$ 514,000 | \$ 434,000 | \$ (30,000) | \$ (191,000) |
| Prior service cost (credit)          | 93,000       | 98,000       | (92,000)   | (93,000)   | 148,000     | 284,000      |
| Accumulated other comprehensive loss | \$ 2,652,000 | \$ 2,863,000 | \$ 422,000 | \$ 341,000 | \$ 118,000  | \$ 93,000    |

Barnwell estimates that it will make approximately \$250,000 in contributions to the pension plan during fiscal 2013. The SERP and Postretirement Medical plans are unfunded and Barnwell will fund benefits when payments are made.

Barnwell does not expect to make any benefit payments under the Postretirement Medical plan during fiscal 2013 and expected payments under the SERP for fiscal 2013 are not significant. Fluctuations in actual market returns as well as changes in general interest rates will result in changes in the market value of plan assets and may result in increased or decreased retirement benefits costs and contributions in future periods.

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The following table presents the weighted-average assumptions used to determine benefit obligations and net benefit costs:

|                                                                           | Pension |       | SERP<br>Year ended September 30, |       | Postretirement Medical |       |
|---------------------------------------------------------------------------|---------|-------|----------------------------------|-------|------------------------|-------|
|                                                                           | 2012    | 2011  | 2012                             | 2011  | 2012                   | 2011  |
| <i>Assumptions used to determine fiscal year-end benefit obligations:</i> |         |       |                                  |       |                        |       |
| Discount rate                                                             | 4.00%   | 4.75% | 4.00%                            | 4.75% | 4.00%                  | 4.75% |
| Rate of compensation increase                                             | 4.00%   | 5.00% | 4.00%                            | 5.00% | N/A                    | N/A   |
| <i>Assumptions used to determine net benefit costs (years ended):</i>     |         |       |                                  |       |                        |       |
| Discount rate                                                             | 4.75%   | 5.00% | 4.75%                            | 5.00% | 4.75%                  | 5.00% |
| Expected return on plan assets                                            | 7.00%   | 7.00% | N/A                              | N/A   | N/A                    | N/A   |
| Rate of compensation increase                                             | 5.00%   | 5.00% | 5.00%                            | 5.00% | N/A                    | N/A   |

We select a discount rate by reference to yields available on the Citigroup Pension Liability Index at our balance sheet date. The expected return on plan assets is primarily based on historical rates of return.

The components of net periodic benefit cost are as follows:

|                                                | Pension    |            | SERP<br>Year ended September 30, |            | Postretirement Medical |           |
|------------------------------------------------|------------|------------|----------------------------------|------------|------------------------|-----------|
|                                                | 2012       | 2011       | 2012                             | 2011       | 2012                   | 2011      |
| <i>Net periodic benefit cost for the year:</i> |            |            |                                  |            |                        |           |
| Service cost                                   | \$ 302,000 | \$ 298,000 | \$ 50,000                        | \$ 45,000  | \$ 12,000              | \$ 12,000 |
| Interest cost                                  | 323,000    | 311,000    | 61,000                           | 58,000     | 49,000                 | 51,000    |
| Expected return on plan assets                 | (327,000)  | (296,000)  | -                                | -          | -                      | -         |
| Amortization of prior service cost (credit)    | 5,000      | 5,000      | (1,000)                          | 4,000      | 136,000                | 136,000   |
| Amortization of net actuarial loss (gain)      | 112,000    | 85,000     | 17,000                           | 14,000     | (11,000)               | (5,000)   |
| Net periodic benefit cost                      | \$ 415,000 | \$ 403,000 | \$ 127,000                       | \$ 121,000 | \$186,000              | \$194,000 |

The amounts that are estimated to be amortized from accumulated other comprehensive income into net periodic benefit cost in the next fiscal year are as follows:

Postretirement

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|                             | Pension    | SERP       | Medical    |
|-----------------------------|------------|------------|------------|
| Prior service cost (credit) | \$ 5,000   | \$ (5,000) | \$ 136,000 |
| Net actuarial loss          | 105,000    | 21,000     | -          |
|                             | \$ 110,000 | \$ 16,000  | \$ 136,000 |

The accumulated benefit obligation differs from the projected benefit obligation in that it assumes future compensation levels will remain unchanged. The accumulated benefit obligation for the pension plan was \$6,263,000 and \$5,284,000 at September 30, 2012 and 2011, respectively. The accumulated benefit obligation for the SERP was \$1,075,000 and \$879,000 at September 30, 2012 and 2011, respectively.

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The benefits expected to be paid under the retirement plans as of September 30, 2012 are as follows:

|                                                     | Pension      | SERP       | Postretirement<br>Medical |
|-----------------------------------------------------|--------------|------------|---------------------------|
| <i>Expected Benefit Payments:</i>                   |              |            |                           |
| Fiscal year ending September 30, 2013               | \$ 156,000   | \$ 5,000   | \$ -                      |
| Fiscal year ending September 30, 2014               | \$ 206,000   | \$ 4,000   | \$ -                      |
| Fiscal year ending September 30, 2015               | \$ 194,000   | \$ 4,000   | \$ -                      |
| Fiscal year ending September 30, 2016               | \$ 182,000   | \$ 3,000   | \$ -                      |
| Fiscal year ending September 30, 2017               | \$ 256,000   | \$ 2,000   | \$ -                      |
| Fiscal years ending September 30, 2018 through 2022 | \$ 1,751,000 | \$ 236,000 | \$ 276,000                |

The following table provides the assumed health care cost trend rates related to the measurement of Barnwell's postretirement medical obligations.

|                                                    | Year ended September 30, |      |
|----------------------------------------------------|--------------------------|------|
|                                                    | <b>2012</b>              | 2011 |
| Health care cost trend rates assumed for next year | <b>8.5%</b>              | 9.0% |
| Ultimate cost trend rate                           | <b>5.0%</b>              | 5.0% |
| Year that the rate reaches the ultimate trend rate | <b>2020</b>              | 2020 |

The assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement medical obligations. A one-percentage-point change in the assumed health care cost trend rates would have the following effects:

|                                                          | 1-Percentage<br>Point Increase | 1-Percentage<br>Point (Decrease) |
|----------------------------------------------------------|--------------------------------|----------------------------------|
| Effect on total service and interest cost components     | \$ 14,000                      | \$ (11,000)                      |
| Effect on accumulated postretirement benefit obligations | \$ 280,000                     | \$ (220,000)                     |

*Plan Assets*

Management communicates periodically with its professional investment advisors to establish investment policies, direct investments and select investment options. The overall investment objective of the Pension Plan is to attain a diversified combination of investments that provides long-term growth in the assets of the plan to fund future benefit

obligations while managing risk in order to meet current benefit obligations. Generally, principal repayments and interest received on government mortgage securities provide cash flows to fund current benefit obligations. Longer-term obligations are generally estimated to be provided for by growth in equity securities. The Company's investment policy permits investments in a diversified mix of U.S. and international equities, fixed income securities and cash equivalents.

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Barnwell's investments in fixed income securities include corporate bonds, U.S. treasuries and preferred securities. The Company's investments in equity securities primarily include large, small, domestic, and international companies. Plan assets include \$8,000 of Barnwell's stock at September 30, 2012. We believe that there are no significant concentrations of risk within our plan assets as of September 30, 2012.

The Company's year-end target allocation, by asset category, and the actual asset allocations were as follows:

| Asset Category          | Target Allocation | September 30, 2012 | September 30, 2011 |
|-------------------------|-------------------|--------------------|--------------------|
| Cash and other          | 0% - 30%          | 1%                 | 15%                |
| Fixed income securities | 20% - 60%         | 30%                | 20%                |
| Equity securities       | 30% - 70%         | 69%                | 65%                |

Actual investment allocations may vary from our target allocations from time to time due to prevailing market conditions. We periodically review our actual investment allocations and rebalance our investments to our target allocations as dictated by current and anticipated market conditions and required cash flows.

We categorize plan assets into three levels based upon the assumptions used to price the assets. Level 1 provides the most reliable measure of fair value, whereas Level 3 requires significant management judgment in determining the fair value. Equity securities are valued by obtaining quoted prices on recognized and highly liquid exchanges. Fixed income securities are valued based upon the closing price reported in the active market in which the security is traded. All of our plan assets are categorized as Level 1 assets, and as such, the actual market value is used to determine the fair value of assets. The following tables set forth by level, within the fair value hierarchy, pension plan assets at their fair value:

|                                    | Carrying Amount as of September 30, 2012 | Fair Value Measurements Using:            |                                               |                                           |
|------------------------------------|------------------------------------------|-------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                                    |                                          | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Financial Assets:                  |                                          |                                           |                                               |                                           |
| Cash                               | \$ 72,000                                | \$ 72,000                                 | \$ -                                          | \$ -                                      |
| U.S. government bonds              | 100,000                                  | 100,000                                   | -                                             | -                                         |
| Corporate bonds                    | 400,000                                  | 400,000                                   | -                                             | -                                         |
| Fixed income exchange-traded funds | 850,000                                  | 850,000                                   | -                                             | -                                         |

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|                      |              |              |      |      |
|----------------------|--------------|--------------|------|------|
| Preferred securities | 232,000      | 232,000      | -    | -    |
| Equities             | 3,734,000    | 3,734,000    | -    | -    |
| Total                | \$ 5,388,000 | \$ 5,388,000 | \$ - | \$ - |

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|                       | Fair Value Measurements Using:                       |                                                       |                                                           |                                                    |
|-----------------------|------------------------------------------------------|-------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                       | Carrying<br>Amount<br>as of<br>September 30,<br>2011 | Quoted<br>Prices in<br>Active<br>Markets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Financial Assets:     |                                                      |                                                       |                                                           |                                                    |
| Cash                  | \$ 625,000                                           | \$ 625,000                                            | \$ -                                                      | \$ -                                               |
| U.S. government bonds | 303,000                                              | 303,000                                               | -                                                         | -                                                  |
| Corporate bonds       | 366,000                                              | 366,000                                               | -                                                         | -                                                  |
| Preferred securities  | 197,000                                              | 197,000                                               | -                                                         | -                                                  |
| Equities              | 2,723,000                                            | 2,723,000                                             | -                                                         | -                                                  |
| Total                 | \$ 4,214,000                                         | \$ 4,214,000                                          | \$ -                                                      | \$ -                                               |

**11. INCOME TAXES**

The components of (loss) earnings before income taxes, after adjusting (loss) earnings for non-controlling interests, are as follows:

|               | Year ended September 30, |                     |
|---------------|--------------------------|---------------------|
|               | 2012                     | 2011                |
| United States | \$ (8,936,000)           | \$ (4,148,000)      |
| Canada        | (2,297,000)              | 5,540,000           |
|               | <b>\$ (11,233,000)</b>   | <b>\$ 1,392,000</b> |

The components of the income tax (benefit) provision related to the above (loss) earnings are as follows:

|                               | Year ended September 30, |         |
|-------------------------------|--------------------------|---------|
|                               | 2012                     | 2011    |
| Current provision:            |                          |         |
| United States Federal         | \$ -                     | \$ -    |
| United States State           | -                        | 18,000  |
|                               | -                        | 18,000  |
| Canadian                      | <b>200,000</b>           | 808,000 |
| Total current                 | <b>200,000</b>           | 826,000 |
| Deferred (benefit) provision: |                          |         |
| United States                 | <b>(380,000)</b>         | 84,000  |
| Canadian                      | <b>(917,000)</b>         | 591,000 |

|                |                |              |
|----------------|----------------|--------------|
| Total deferred | (1,297,000)    | 675,000      |
|                | \$ (1,097,000) | \$ 1,501,000 |

Barnwell's effective consolidated income tax rate for fiscal 2012, after adjusting (loss) earnings before income taxes for non-controlling interests, was 10%, as compared to 108% for fiscal 2011.

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Consolidated taxes do not bear a customary relationship to pretax (losses) earnings due mainly to the fact that Canadian income taxes are not sheltered by U.S. source losses, Canadian income taxes are not estimated to have a current or future benefit as foreign tax credits or deductions for U.S. tax purposes, and U.S. consolidated net operating losses are not estimated to have a future U.S. tax benefit prior to expiration. In addition, included in the income tax benefit for fiscal 2012 and the income tax provision for fiscal 2011 are \$93,000 and \$257,000 uncertain tax position benefits, respectively, from lapses of the statute of limitations for uncertain tax positions related to Canadian income taxes.

A reconciliation between the reported income tax (benefit) provision and the amount computed by multiplying the (loss) earnings attributable to Barnwell before income taxes by the U.S. federal tax rate of 35% is as follows:

|                                                                           | Year ended September 30, |              |
|---------------------------------------------------------------------------|--------------------------|--------------|
|                                                                           | 2012                     | 2011         |
| Tax (benefit) expense computed by applying statutory rate                 | \$ (3,932,000)           | \$ 487,000   |
| Increase in the valuation allowance                                       | 3,968,000                | 928,000      |
| Additional effect of the foreign tax provision on the total tax provision | (606,000)                | 390,000      |
| State income tax (benefit) expense                                        | (389,000)                | 18,000       |
| Uncertain tax positions lapses of statute                                 | (93,000)                 | (257,000)    |
| Other                                                                     | (45,000)                 | (65,000)     |
|                                                                           | \$ (1,097,000)           | \$ 1,501,000 |

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

|                                                                                                            | September 30,  |                |
|------------------------------------------------------------------------------------------------------------|----------------|----------------|
|                                                                                                            | 2012           | 2011           |
| Deferred income tax assets:                                                                                |                |                |
| U.S. tax effect of deferred Canadian taxes                                                                 | \$ 1,082,000   | \$ 1,323,000   |
| Foreign tax credit carryover                                                                               | 1,955,000      | 1,656,000      |
| Alternative minimum tax credit carryover                                                                   | 460,000        | 460,000        |
| U.S. federal net operating loss carryover                                                                  | 2,613,000      | 79,000         |
| Tax basis of investment in land and residential real estate in excess of book basis                        | 1,661,000      | 1,383,000      |
| Property and equipment accumulated tax depreciation and depletion in excess of book under U.S. tax law     | 4,480,000      | 4,655,000      |
| Liabilities accrued for books but not for tax under U.S. tax law                                           | 4,192,000      | 4,242,000      |
| Liabilities accrued for books but not for tax under Canadian tax law                                       | 1,732,000      | 1,616,000      |
| Other                                                                                                      | 1,869,000      | 1,177,000      |
| Total gross deferred tax assets                                                                            | 20,044,000     | 16,591,000     |
| Less valuation allowance                                                                                   | (18,233,000)   | (14,975,000)   |
| Net deferred income tax assets                                                                             | 1,811,000      | 1,616,000      |
| Deferred income tax liabilities:                                                                           |                |                |
| Property and equipment accumulated tax depreciation and depletion in excess of book under Canadian tax law | (4,913,000)    | (5,508,000)    |
| Other                                                                                                      | (92,000)       | (392,000)      |
| Total deferred income tax liabilities                                                                      | (5,005,000)    | (5,900,000)    |
| Net deferred income tax liability                                                                          | \$ (3,194,000) | \$ (4,284,000) |

Net deferred income tax liability is included in the Consolidated Balance Sheets as follows:

|                                                                      | September 30,  |                |
|----------------------------------------------------------------------|----------------|----------------|
|                                                                      | 2012           | 2011           |
| Current deferred income tax asset (included in other current assets) | \$ 113,000     | \$ 197,000     |
| Deferred income tax liability                                        | (3,307,000)    | (4,481,000)    |
| Net deferred income tax liability                                    | \$ (3,194,000) | \$ (4,284,000) |

The total valuation allowance increased \$3,258,000 for the year ended September 30, 2012. The increase was due primarily to a U.S. federal net operating loss, asset impairments for books but not tax, and an increase in foreign tax credit carryovers. Of the total increase in the valuation allowance for fiscal 2012, \$3,968,000 was recognized as income tax expense and \$710,000 was credited to accumulated other comprehensive income.

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Net deferred tax assets at September 30, 2012 of \$1,811,000 consists primarily of Canadian deferred tax assets related to liabilities accrued for book purposes but not for tax purposes that are estimated to be realized through future Canadian income tax deductions against future Canadian oil and natural gas earnings.

At September 30, 2012, Barnwell had foreign tax credit carryovers, alternative minimum tax credit carryovers, and U.S. federal net operating loss carryovers totaling \$1,955,000, \$460,000 and \$7,687,000, respectively. All three items were fully offset by valuation allowances at September 30, 2012. The net operating loss carryovers expire in fiscal years 2031-2032, and the foreign tax credit carryovers expire in fiscal years 2013-2022.

FASB ASC Topic 740, *Income Taxes*, 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.

Barnwell files U.S. federal income tax returns, income tax returns in various U.S. states, and Canadian federal and provincial tax returns. A number of years may elapse before an uncertain tax position, for which we have unrecognized tax benefits, is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, we believe that our unrecognized tax benefits reflect the more likely than not outcome. We adjust these unrecognized tax benefits, as well as the related interest, based on ongoing changes in facts and circumstances. Settlement of any particular position could require the use of cash. Favorable resolution for an amount less than the amount estimated by Barnwell would be recognized as a decrease in the effective income tax rate in the period of resolution, and unfavorable resolution in excess of the amount estimated by Barnwell would be recognized as an increase in the effective income tax rate in the period of resolution.

In November 2010, the Company settled and paid the province of Alberta's reassessment of Canadian provincial taxes. The Alberta provincial reassessment resulted from the Canada Revenue Agency's examination of the Company's fiscal 2005 and 2006 Canadian federal returns, which was settled in September 2010. There was no material difference between the province of Alberta's reassessment and the related uncertain tax provision previously recorded by the Company.

The Canada Revenue Agency is currently examining the Company's Canadian federal income tax returns for fiscal 2010 and 2011.

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Below are the changes in uncertain tax positions.

|                                              | Tax Positions<br>Taken | Accrued<br>Interest | Total<br>Unrecognized<br>Tax<br>Benefits |
|----------------------------------------------|------------------------|---------------------|------------------------------------------|
| Balance as of September 30, 2010             | \$ 980,000             | \$ 257,000          | \$ 1,237,000                             |
| Effect of tax positions taken in prior years | 11,000                 | (4,000)             | 7,000                                    |
| Settlements                                  | (172,000)              | (67,000)            | (239,000)                                |
| Lapse of statute                             | (155,000)              | (102,000)           | (257,000)                                |
| Translation adjustments                      | 7,000                  | 6,000               | 13,000                                   |
| Balance as of September 30, 2011             | 671,000                | 90,000              | 761,000                                  |
| Effect of tax positions taken in prior years | -                      | 13,000              | 13,000                                   |
| Lapse of statute                             | (61,000)               | (32,000)            | (93,000)                                 |
| Translation adjustments                      | 37,000                 | 4,000               | 41,000                                   |
| <b>Balance as of September 30, 2012</b>      | <b>\$ 647,000</b>      | <b>\$ 75,000</b>    | <b>\$ 722,000</b>                        |

The total amount of unrecognized tax benefits at September 30, 2012 that, if recognized, would impact the effective tax rate was \$722,000.

Uncertain tax positions consist of Canadian federal and provincial audit issues that involve transfer pricing adjustments. Because of a lack of clarity and uniformity regarding allowable transfer pricing valuations by differing jurisdictions, it is reasonably possible that the total amount of uncertain tax positions may significantly increase or decrease within the next 12 months, and the estimated range of any such variance is not currently estimable based upon facts and circumstances as of September 30, 2012.

Included below is a summary of the tax years, by jurisdiction, that remain subject to examination by taxing authorities at September 30, 2012:

| Jurisdiction               | Fiscal Years Open |      |
|----------------------------|-------------------|------|
| U.S. federal               | 2006, 2009        | 2011 |
| Various U.S. states        | 2009              | 2011 |
| Canada federal             | 2005              | 2011 |
| Various Canadian provinces | 2005              | 2011 |

## 12. SEGMENT AND GEOGRAPHIC INFORMATION

Barnwell operates the following segments: 1) exploring for, developing, producing and selling oil and natural gas in Canada (oil and natural gas); 2) investing in land interests in Hawaii (land investment); 3) drilling wells and installing and repairing water pumping systems in Hawaii (contract drilling); and 4) developing homes for sale in Hawaii (residential real estate).

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The following table presents certain financial information related to Barnwell's reporting segments. All revenues reported are from external customers with no intersegment sales or transfers.

|                                                                          | Year ended September 30, |               |
|--------------------------------------------------------------------------|--------------------------|---------------|
|                                                                          | 2012                     | 2011          |
| Revenues:                                                                |                          |               |
| Oil and natural gas                                                      | \$ 24,610,000            | \$ 30,228,000 |
| Land investment                                                          | 482,000                  | 3,742,000     |
| Contract drilling                                                        | 2,340,000                | 3,855,000     |
| Residential real estate                                                  | 5,975,000                | -             |
| Other                                                                    | 633,000                  | 596,000       |
| Total before interest income                                             | 34,040,000               | 38,421,000    |
| Interest income                                                          | 22,000                   | 39,000        |
| Total revenues                                                           | \$ 34,062,000            | \$ 38,460,000 |
| Depletion, depreciation, and amortization:                               |                          |               |
| Oil and natural gas                                                      | \$ 10,367,000            | \$ 9,469,000  |
| Contract drilling                                                        | 509,000                  | 560,000       |
| Other                                                                    | 114,000                  | 98,000        |
| Total depletion, depreciation, and amortization                          | \$ 10,990,000            | \$ 10,127,000 |
| Reduction of carrying value of assets:                                   |                          |               |
| Oil and natural gas                                                      | \$ 2,551,000             | \$ -          |
| Land investment                                                          | 488,000                  | 689,000       |
| Residential real estate                                                  | 1,854,000                | 418,000       |
| Other                                                                    | 1,754,000                | 121,000       |
| Total reduction of carrying value of assets                              | \$ 6,647,000             | \$ 1,228,000  |
| Operating (loss) profit<br>(before general and administrative expenses): |                          |               |
| Oil and natural gas                                                      | \$ 1,247,000             | \$ 9,355,000  |
| Land investment                                                          | (6,000)                  | 3,053,000     |
| Contract drilling                                                        | (1,160,000)              | (587,000)     |
| Residential real estate                                                  | (1,869,000)              | (418,000)     |
| Other                                                                    | (1,235,000)              | 377,000       |
| Total operating (loss) profit                                            | (3,023,000)              | 11,780,000    |
| General and administrative expenses                                      | (8,268,000)              | (9,025,000)   |
| Interest expense                                                         | (790,000)                | (1,088,000)   |
| Interest income                                                          | 22,000                   | 39,000        |

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|                                     |    |              |    |           |
|-------------------------------------|----|--------------|----|-----------|
| (Loss) earnings before income taxes | \$ | (12,059,000) | \$ | 1,706,000 |
|-------------------------------------|----|--------------|----|-----------|

Table of Contents*Capital Expenditures:*

|                     | Year ended September 30, |               |
|---------------------|--------------------------|---------------|
|                     | 2012                     | 2011          |
| Oil and natural gas | \$ 4,915,000             | \$ 13,299,000 |
| Contract drilling   | 72,000                   | 186,000       |
| Other               | 35,000                   | 1,919,000     |
| Total               | \$ 5,022,000             | \$ 15,404,000 |

*Assets By Segment:*

|                             | September 30, |               |
|-----------------------------|---------------|---------------|
|                             | 2012          | 2011          |
| Oil and natural gas (1)     | \$ 46,946,000 | \$ 54,454,000 |
| Land investment (2)         | 2,381,000     | 2,869,000     |
| Contract drilling (2)       | 2,963,000     | 3,660,000     |
| Residential real estate (2) | 5,309,000     | 12,640,000    |
| Other:                      |               |               |
| Cash and cash equivalents   | 8,845,000     | 9,834,000     |
| Corporate and other         | 3,446,000     | 5,315,000     |
| Total                       | \$ 69,890,000 | \$ 88,772,000 |

(1) Primarily located in the province of Alberta, Canada.

(2) Located in Hawaii.

*Long-Lived Assets By Geographic Area:*

|               | September 30, |               |
|---------------|---------------|---------------|
|               | 2012          | 2011          |
| United States | \$ 7,161,000  | \$ 9,911,000  |
| Canada        | 43,844,000    | 49,331,000    |
| Total         | \$ 51,005,000 | \$ 59,242,000 |

*Revenue By Geographic Area:*

|                                   | Year ended September 30, |               |
|-----------------------------------|--------------------------|---------------|
|                                   | 2012                     | 2011          |
| United States                     | \$ 8,892,000             | \$ 7,640,000  |
| Canada                            | 25,148,000               | 30,781,000    |
| Total (excluding interest income) | \$ 34,040,000            | \$ 38,421,000 |

Table of Contents**13. ACCUMULATED OTHER COMPREHENSIVE INCOME**

Components of accumulated other comprehensive income, net of taxes, are as follows:

|                                        |              | September 30, |             |
|----------------------------------------|--------------|---------------|-------------|
|                                        | 2012         |               | 2011        |
| Foreign currency translation           | \$ 5,020,000 | \$            | 3,093,000   |
| Retirement plans liability             | (2,698,000)  |               | (2,803,000) |
| Accumulated other comprehensive income | \$ 2,322,000 | \$            | 290,000     |

**14. FAIR VALUE MEASUREMENTS***Assets and Liabilities Measured at Fair Value on a Recurring Basis*

Barnwell does not have any assets and liabilities that are required to be remeasured on a recurring basis.

*Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

Certain of our assets and liabilities are reported at fair value in the accompanying balance sheets on a nonrecurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances. The following tables provide carrying value and fair value measurement information for nonrecurring fair value measurements recorded during the years ended September 30, 2012 and 2011:

Year ended September 30, 2012:

| Carrying<br>Amount<br>as of<br>September 30,<br>2012 | Quoted<br>Prices in<br>Active<br>Markets<br>(Level 1) | Fair Value Measurements Using*:                           |                                                    | Total Reduction of<br>Carrying Value<br>for the<br>year ended<br>September 30, 2012 |
|------------------------------------------------------|-------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------------------------------------------------------------------------------|
|                                                      |                                                       | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                                                                                     |
| \$ 5,309,000                                         | \$ -                                                  | \$ 5,309,000                                              | \$ -                                               | \$ 1,854,000                                                                        |

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Real estate held for  
sale

Investment in joint  
ventures

|    |   |    |   |    |   |    |   |    |           |
|----|---|----|---|----|---|----|---|----|-----------|
| \$ | - | \$ | - | \$ | - | \$ | - | \$ | 1,754,000 |
|----|---|----|---|----|---|----|---|----|-----------|

Lot acquisition rights

Mauka Lands

|    |   |    |   |    |   |    |   |    |         |
|----|---|----|---|----|---|----|---|----|---------|
| \$ | - | \$ | - | \$ | - | \$ | - | \$ | 488,000 |
|----|---|----|---|----|---|----|---|----|---------|

Table of ContentsYear ended September 30, 2011:

|                                   | Carrying<br>Amount<br>as of<br>September 30,<br>2011 | Quoted<br>Prices in<br>Active<br>Markets<br>(Level 1) | Fair Value Measurements Using*:                           |                                                    | Total Reduction of<br>Carrying Value<br>for the<br>year ended<br>September 30, 2011 |
|-----------------------------------|------------------------------------------------------|-------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------------------------------------------------------------------------------|
|                                   |                                                      |                                                       | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                                                                                     |
| Real estate held for sale         | \$ 12,640,000                                        | \$ -                                                  | \$ 12,640,000                                             | \$ -                                               | \$ 418,000                                                                          |
| Investment in residential parcels | \$ 2,331,000                                         | \$ -                                                  | \$ 2,331,000                                              | \$ -                                               | \$ 689,000                                                                          |
| Investment in joint ventures      | \$ 1,754,000                                         | \$ -                                                  | \$ -                                                      | \$ 1,754,000                                       | \$ 121,000                                                                          |

\* The fair values included in the tables above represent only those assets whose carrying values were adjusted to fair value in each respective period.

The fair value of real estate held for sale for the year ended September 30, 2012 was based on the sales price of the home sold, which is similar and located adjacent to the remaining home. This fair value measurement has been classified as a Level 2 valuation.

Due to recent uncertainty regarding the financial condition of the joint venture entities in which the Company has passive interests and the duration of current economic conditions and the corresponding impact of such conditions on the Company's ability to recover its investment within the Company's currently estimated holding period, the Company wrote off its remaining \$1,754,000 investment in joint ventures in fiscal 2012 as management has concluded that there has been an other-than-temporary impairment of these investments.

Due to recent heightened uncertainty regarding the likelihood of development of the Mauka Lands, and accordingly, the corresponding impact of such conditions on the Company's ability to recover its investment in lot acquisition rights, the Company wrote off its remaining \$488,000 investment in lot acquisition rights in fiscal 2012.

For the year ended September 30, 2011, in determining the fair value of Barnwell's real estate held for sale and investment in residential parcels, prices for comparable sales transactions were used by an independent real estate consulting and appraisal firm to estimate fair value. Such fair value measurements have been classified as Level 2 valuations.

Kona Village Resort sustained considerable damage as a result of the March 2011 tsunami and subsequently shut down indefinitely. As a result of the resort's shutdown, Barnwell determined that the fair value of its investment in Kona Village Resort was zero and wrote off its investment in Kona Village Investors, LLC.

Barnwell estimates the fair value of asset retirement obligations based on the projected discounted future cash outflows required to settle abandonment and restoration liabilities. Such an estimate requires assumptions and judgments regarding the existence of liabilities, the amount and timing of cash outflows required to settle the liability, what constitutes adequate restoration, inflation factors, credit adjusted discount rates, and consideration of changes in legal, regulatory, environmental and political environments. Abandonment and restoration cost estimates are determined in conjunction with Barnwell's reserve engineers based on historical information regarding costs incurred to abandon and restore similar well sites, information regarding current market conditions and costs, and knowledge

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of subject well sites and properties. Asset retirement obligation fair value measurements in the current period were Level 3 fair value measurements. As further described in Note 7, the Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made. Asset retirement obligations are not measured at fair value subsequent to initial recognition.

*Fair Value of Financial Instruments*

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, accrued current liabilities and payables to joint interest owners approximate their fair values due to the short-term nature of the 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.

**15. COMMITMENTS AND CONTINGENCIES**

Barnwell has several non-cancelable operating leases for office space and leasehold land. Rental expense was \$476,000 in 2012 and \$504,000 in 2011. Barnwell is committed under these leases for minimum rental payments summarized by fiscal year as follows:

| <u>Fiscal year ending</u> |    |           |
|---------------------------|----|-----------|
| 2013                      | \$ | 579,000   |
| 2014                      |    | 508,000   |
| 2015                      |    | 185,000   |
| 2016                      |    | 185,000   |
| 2017                      |    | 161,000   |
| Thereafter through 2026   |    | 215,000   |
| Total                     | \$ | 1,833,000 |

The lease payments for land were subject to renegotiation as of January 1, 2006. Per the lease agreement, the lease payments will remain unchanged pending an appraisal, whereupon the lease rent could be adjusted to fair market value. Barnwell does not know the amount of the new lease payments which could be effective upon performance of the appraisal; they may remain unchanged or increase, and Barnwell currently expects the adjustment, if any, to not be material. The future rental payment disclosures above assume the minimum lease payments for land in effect at December 31, 2005 remain unchanged through December 2025, the end of the lease term.

Barnwell is obligated to pay Nearco, Inc. 4.2% of Kaupulehu Developments' gross receipts from real estate transactions. The fees represent compensation for promotion and marketing of Kaupulehu Developments' property and were determined based on the estimated fair value of such services.

In conjunction with the closing of the Increment II transaction in fiscal 2006, Kaupulehu Developments entered into an agreement to pay its external real estate legal counsel 1.5% of all Increment II percentage of sales payments received by Kaupulehu Developments for services provided by its external real estate legal counsel in the negotiation and closing of the Increment II transaction. No amounts were paid pursuant to this arrangement in fiscal years 2012 or 2011.

Barnwell, as an investor in various joint ventures, may be periodically called upon to make additional capital contributions.

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Barnwell is occasionally involved in routine litigation and is subject to governmental and regulatory controls that are incidental to the ordinary course of business. Barnwell's management believes that all claims and litigation involving Barnwell are not likely to have a material adverse effect on its results of operations, financial position or liquidity.

## 16. CONCENTRATIONS OF CREDIT RISK

Our oil and natural gas segment's primary concentration of credit risk is associated with the following individually significant customers: Shell Trading Canada, Entegral Energy Marketing Inc. and ProGas Limited. At September 30, 2012, these customers accounted for 54%, 15% and 11%, respectively, or in aggregate \$1,266,000, of our oil and natural gas accounts receivables. No other customer accounted for more than 10% of our oil and natural gas accounts receivables.

At September 30, 2012, Barnwell's contract drilling subsidiary had accounts receivables from federal, state of Hawaii and county entities totaling \$150,000. Barnwell has lien rights on wells drilled and pumps installed for federal, state of Hawaii, county and private entities.

Management does not believe significant credit risk related to these trade receivables exists at September 30, 2012 based on prior historical experience.

## 17. INFORMATION RELATING TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS

The following table details the effect of changes in current assets and liabilities on the Consolidated Statements of Cash Flows, and presents supplemental cash flow information:

|                                             | Year ended September 30, |              |
|---------------------------------------------|--------------------------|--------------|
|                                             | 2012                     | 2011         |
| <i>Increase (decrease) from changes in:</i> |                          |              |
| Receivables                                 | \$ 2,409,000             | \$ 2,894,000 |
| Other current assets                        | 46,000                   | 656,000      |
| Accounts payable                            | (214,000)                | 1,378,000    |
| Accrued compensation                        | (739,000)                | (7,000)      |
| Other current liabilities                   | (357,000)                | (1,073,000)  |

|                                                         |    |                  |    |           |
|---------------------------------------------------------|----|------------------|----|-----------|
| Increase from changes in current assets and liabilities | \$ | <b>1,145,000</b> | \$ | 3,848,000 |
|---------------------------------------------------------|----|------------------|----|-----------|

*Supplemental disclosure of cash flow information:*

Cash paid during the year for:

|              |    |                |    |           |
|--------------|----|----------------|----|-----------|
| Interest     | \$ | <b>743,000</b> | \$ | 996,000   |
| Income taxes | \$ | <b>457,000</b> | \$ | 1,774,000 |

*Supplemental disclosure of non-cash investing and financing activities:*

|                                      |    |   |    |            |
|--------------------------------------|----|---|----|------------|
| Long-term debt borrowings refinanced | \$ | - | \$ | 12,500,000 |
|--------------------------------------|----|---|----|------------|

Capital expenditure accruals related to oil and natural gas exploration and development decreased \$2,245,000 and increased \$298,000 during the years ended September 30, 2012 and 2011, respectively. Additionally, during the years ended September 30, 2012 and 2011, capital expenditure accruals related to oil and natural gas asset retirement obligations increased \$388,000 and decreased \$207,000, respectively.

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**18.            SUBSEQUENT EVENTS**

There were no material subsequent events that would require recognition or disclosure in the accompanying consolidated financial statements.

**19.            SUMMARY OF SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

Disclosure is not required as Barnwell qualifies as a smaller reporting company.

**20.            SUPPLEMENTARY OIL AND NATURAL GAS INFORMATION (UNAUDITED)**

The following tables summarize information relative to Barnwell's oil and natural gas operations, which are conducted in Canada. Proved reserves are the estimated quantities of oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved producing oil and natural gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. The estimated net interests in total proved and proved producing reserves are based upon subjective engineering judgments and may be affected by the limitations inherent in such estimations. The process of estimating reserves is subject to continual revision as additional information becomes available as a result of drilling, testing, reservoir studies and production history. There can be no assurance that such estimates will not be materially revised in subsequent periods.

Table of Contents*(A) Oil and Natural Gas Reserves*

The following table summarizes changes in the estimates of Barnwell's net interests in total proved developed reserves of oil and natural gas liquids and natural gas, which are all in Canada. The Company has no proved undeveloped reserves. All of the information regarding reserves in this Form 10-K is derived from the report of our independent petroleum reserve engineers, InSite, and is included as an Exhibit to this Form 10-K.

|                                             | OIL & NGL<br>(Bbls) | GAS<br>(Mcf)      | Total<br>(Boe)   |
|---------------------------------------------|---------------------|-------------------|------------------|
| Proved reserves:                            |                     |                   |                  |
| Balance at September 30, 2010               | 1,272,000           | 17,867,000        | 4,353,000        |
| Revisions of previous estimates             | 42,000              | (298,000)         | (10,000)         |
| Extensions, discoveries and other additions | 120,000             | 324,000           | 176,000          |
| Less production                             | (250,000)           | (2,950,000)       | (759,000)        |
| Balance at September 30, 2011               | 1,184,000           | 14,943,000        | 3,760,000        |
| Revisions of previous estimates             | 97,000              | (1,121,000)       | (96,000)         |
| Extensions, discoveries and other additions | 56,000              | 40,000            | 63,000           |
| Less production                             | (259,000)           | (2,753,000)       | (734,000)        |
| <b>Balance at September 30, 2012</b>        | <b>1,078,000</b>    | <b>11,109,000</b> | <b>2,993,000</b> |

*(B) Capitalized Costs Relating to Oil and Natural Gas Producing Activities*

All capitalized costs relating to oil and natural gas producing activities, which were being depleted in all years, are summarized as follows:

|                                        | September 30,  |                |
|----------------------------------------|----------------|----------------|
|                                        | 2012           | 2011           |
| Proved properties                      | \$ 238,788,000 | \$ 220,362,000 |
| Unproved properties                    | 3,645,000      | 4,490,000      |
| Total capitalized costs                | 242,433,000    | 224,852,000    |
| Accumulated depletion and depreciation | 198,768,000    | 175,715,000    |
| Net capitalized costs                  | \$ 43,665,000  | \$ 49,137,000  |



Table of Contents*(C) Costs Incurred in Oil and Natural Gas Property Acquisition, Exploration and Development*

|                            | Year ended September 30, |               |
|----------------------------|--------------------------|---------------|
|                            | 2012                     | 2011          |
| Acquisition of properties: |                          |               |
| Unproved                   | \$ 496,000               | \$ 1,455,000  |
| Proved                     | -                        | -             |
| Exploration costs          | 1,778,000                | 2,253,000     |
| Development costs          | 2,641,000                | 9,591,000     |
| Total                      | \$ 4,915,000             | \$ 13,299,000 |

*(D) Results of Operations for Oil and Natural Gas Producing Activities*

|                                                               | Year ended September 30, |               |
|---------------------------------------------------------------|--------------------------|---------------|
|                                                               | 2012                     | 2011          |
| Net revenues                                                  | \$ 24,610,000            | \$ 28,804,000 |
| Production costs                                              | 10,445,000               | 11,404,000    |
| Depletion                                                     | 10,367,000               | 9,469,000     |
| Reduction of carrying value of oil and natural gas properties | 2,551,000                | -             |
| Pre-tax results of operations*                                | 1,247,000                | 7,931,000     |
| Estimated income tax expense                                  | (387,000)                | (2,459,000)   |
| Results of operations*                                        | \$ 860,000               | \$ 5,472,000  |

\* Before general and administrative expenses, interest expense, and foreign exchange gains and losses.

*(E) Standardized Measure, Including Year-to-Year Changes Therein, of Estimated Discounted Future Net Cash Flows*

The following tables utilize reserve and production data estimated by independent petroleum reserve engineers. The information may be useful for certain comparison purposes but should not be solely relied upon in evaluating Barnwell or its performance. Moreover, the projections should not be construed as realistic estimates of future cash

flows, nor should the standardized measure be viewed as representing current value.

The estimated future cash flows at September 30, 2012 and 2011 were based on weighted average sales prices, based upon the average of the price in effect on the first day of the month for the preceding twelve month period in accordance with SEC Release No. 33-8995. The future production and development costs represent the estimated future expenditures that we will incur to develop and produce the proved reserves, assuming continuation of existing economic conditions. The future income tax expenses were computed by applying statutory income tax rates in existence at September 30, 2012 and 2011 to the future pre-tax net cash flows relating to proved reserves, net of the tax basis of the properties involved.

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Material revisions to reserve estimates may occur in the future, development and production of the oil and natural gas reserves may not occur in the periods assumed and actual prices realized and actual costs incurred are expected to vary significantly from those used. Management does not rely upon this information in making investment and operating decisions; rather, those decisions are based upon a wide range of factors, including estimates of probable reserves as well as proved reserves and price and cost assumptions different than those reflected herein.

Standardized Measure of Discounted Future Net Cash Flows

|                                                          | September 30,  |                |
|----------------------------------------------------------|----------------|----------------|
|                                                          | 2012           | 2011           |
| Future cash inflows                                      | \$ 109,253,000 | \$ 142,198,000 |
| Future production costs                                  | (51,603,000)   | (61,271,000)   |
| Future development costs                                 | (2,044,000)    | (2,428,000)    |
| Future income tax expenses                               | (8,260,000)    | (13,839,000)   |
| Future net cash flows                                    | 47,346,000     | 64,660,000     |
| 10% annual discount for timing of cash flows             | (12,056,000)   | (16,101,000)   |
| Standardized measure of discounted future net cash flows | \$ 35,290,000  | \$ 48,559,000  |

Changes in the Standardized Measure of Discounted Future Net Cash Flows

|                                                                                 | Year ended September 30, |               |
|---------------------------------------------------------------------------------|--------------------------|---------------|
|                                                                                 | 2012                     | 2011          |
| Beginning of year                                                               | \$ 48,559,000            | \$ 49,626,000 |
| Sales of oil and natural gas produced, net of production costs                  | (14,165,000)             | (17,400,000)  |
| Net changes in prices and production costs, net of royalties and wellhead taxes | (17,851,000)             | 2,461,000     |
| Extensions and discoveries                                                      | 2,312,000                | 4,407,000     |
| Revisions of previous quantity estimates                                        | 4,084,000                | 2,030,000     |
| Net change in income taxes                                                      | 5,171,000                | 479,000       |
| Accretion of discount                                                           | 5,129,000                | 4,919,000     |
| Other - changes in the timing of future production and other                    | (307,000)                | 1,578,000     |
| Other - net change in Canadian dollar translation rate                          | 2,358,000                | 459,000       |
| Net change                                                                      | (13,269,000)             | (1,067,000)   |
| End of year                                                                     | \$ 35,290,000            | \$ 48,559,000 |

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

None.

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**ITEM 9A. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

We have established disclosure controls and procedures to ensure that material information relating to Barnwell, including its consolidated subsidiaries, is made known to the officers who certify Barnwell's financial reports and to other members of executive management and the Board of Directors.

As of September 30, 2012, an evaluation was carried out by Barnwell's Chief Executive Officer and Chief Financial Officer of the effectiveness of Barnwell's 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 (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective as of September 30, 2012 to ensure that information required to be disclosed by Barnwell in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities Exchange Act of 1934 and the rules thereunder.

**Management's Annual Report on Internal Control Over Financial Reporting**

Barnwell's management is responsible for establishing and maintaining adequate internal control over financial reporting for Barnwell, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Under the supervision and with the participation of Barnwell's management, including our Chief Executive Officer and Chief Financial Officer, Barnwell conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework in *Internal Control over Financial Reporting – Guidance for Smaller Public Companies* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Framework"). Based on this evaluation under the COSO Framework, management concluded that its internal control over financial reporting was effective as of September 30, 2012.

**Changes in Internal Control Over Financial Reporting**

There was no change in Barnwell's internal control over financial reporting during the quarter ended September 30, 2012 that materially affected, or is reasonably likely to materially affect, Barnwell's internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required is omitted pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement for the 2012 Annual Meeting of Stockholders no later than 120 days after the close of its fiscal year ended September 30, 2012, which proxy statement is incorporated herein by reference.

Barnwell adopted a Code of Ethics that applies to its Chief Executive Officer and the Chief Financial Officer. This Code of Ethics has been posted on Barnwell's website at [www.brninc.com](http://www.brninc.com).

Table of Contents**ITEM 11. EXECUTIVE COMPENSATION**

The information required is omitted pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement for the 2012 Annual Meeting of Stockholders no later than 120 days after the close of its fiscal year ended September 30, 2012, which proxy statement is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required is omitted pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement for the 2012 Annual Meeting of Stockholders no later than 120 days after the close of its fiscal year ended September 30, 2012, which proxy statement is incorporated herein by reference.

*Equity Compensation Plan Information*

The following table provides information about Barnwell's common stock that may be issued upon exercise of options and rights under all of Barnwell's existing equity compensation plans as of September 30, 2012:

|                                                            | (a)<br>Number of<br>securities<br>to be issued<br>upon exercise<br>of outstanding<br>options, warrants<br>and rights | (b)<br>Weighted-<br>average<br>price of<br>outstanding<br>options,<br>warrants<br>and rights | (c)<br>Number of securities<br>remaining available<br>for future issuance<br>under equity<br>compensation plans<br>(excluding securities<br>reflected in column (a)) |
|------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Plan Category                                              |                                                                                                                      |                                                                                              |                                                                                                                                                                      |
| Equity compensation plans approved by security holders     | 815,375                                                                                                              | \$8.41                                                                                       | 122,500                                                                                                                                                              |
| Equity compensation plans not approved by security holders | -                                                                                                                    | -                                                                                            | -                                                                                                                                                                    |
| Total                                                      | 815,375                                                                                                              | \$8.41                                                                                       | 122,500                                                                                                                                                              |

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required is omitted pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement for the 2012 Annual Meeting of Stockholders no later than 120 days after the close of its fiscal year ended September 30, 2012, which proxy statement is incorporated herein by reference.

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**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required is omitted pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement for the 2012 Annual Meeting of Stockholders no later than 120 days after the close of its fiscal year ended September 30, 2012, which proxy statement is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

(a) Financial Statements

The following consolidated financial statements of Barnwell Industries, Inc. and its subsidiaries are included in Part II, Item 8:

Report of Independent Registered Public Accounting Firm KPMG LLP

Consolidated Balance Sheets September 30, 2012 and 2011

Consolidated Statements of Operations for the years ended September 30, 2012 and 2011

Consolidated Statements of Comprehensive (Loss) Income  
for the years ended September 30, 2012 and 2011

Consolidated Statements of Cash Flows for the years ended September 30, 2012 and 2011

Consolidated Statements of Equity for the years ended September 30, 2012 and 2011

Notes to Consolidated Financial Statements

Schedules have been omitted because they were not applicable, not required, or the information is included in the consolidated financial statements or notes thereto.

(b) Exhibits

| Exhibit<br>Number | Description                                                                                                                                 |
|-------------------|---------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1               | Certificate of Incorporation <sup>(1)</sup>                                                                                                 |
| 3.2               | Amended and Restated By-Laws <sup>(2)</sup>                                                                                                 |
| 4.0               | Form of the Registrant's certificate of common stock, par value \$.50 per share <sup>(3)</sup>                                              |
| 10.1              | The Barnwell Industries, Inc. Employees' Pension Plan (restated as of October 1, 1989) <sup>(4)</sup>                                       |
| 10.2              | Phase I Makai Development Agreement dated June 30, 1992, by and between Kaupulehu Makai Venture and Kaupulehu Developments <sup>(5)</sup>   |
| 10.3              | KD/KMV Agreement dated June 30, 1992 by and between Kaupulehu Makai Venture and Kaupulehu Developments <sup>(5)</sup>                       |
| 10.4              | Form of Purchase and Sale Agreement dated February 13, 2004 by and between Kaupulehu Developments and WB KD Acquisition, LLC <sup>(6)</sup> |

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|         |                                                                                                                                                                                 |
|---------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.5    | Form of Agreement Re Step In Rights of Kaupulehu Developments dated February 13, 2004 <sup>(7)</sup>                                                                            |
| 10.6    | Agreement dated May 27, 2009 which became effective June 23, 2009 by and between Kaupulehu Developments and WB KD Acquisition, LLC and WB KD Acquisition II, LLC <sup>(8)</sup> |
| 21      | List of Subsidiaries                                                                                                                                                            |
| 23.1    | Consent of KPMG LLP                                                                                                                                                             |
| 23.2    | Consent of InSite Petroleum Consultants Ltd.                                                                                                                                    |
| 31.1    | Certification of Chief Executive Officer Pursuant To Section 302 of the Sarbanes-Oxley Act of 2002                                                                              |
| 31.2    | Certification of Chief Financial Officer Pursuant To Section 302 of the Sarbanes-Oxley Act of 2002                                                                              |
| 32      | Certification Pursuant To Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                         |
| 99.1    | Reserve Report Summary prepared by InSite Petroleum Consultants Ltd.                                                                                                            |
| 101.INS | XBRL Instance Document                                                                                                                                                          |
| 101.SCH | XBRL Taxonomy Extension Schema Document                                                                                                                                         |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document                                                                                                                           |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document                                                                                                                            |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document                                                                                                                                 |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                                          |

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(1) Incorporated by reference to the Registrant's Form S-8 dated November 8, 1991.

(2) Incorporated by reference to the Registrant's Form 8-K filed December 12, 2007.

(3) Incorporated by reference to the registration statement on Form S-1 originally filed by the Registrant January 29, 1957 and as amended February 15, 1957 and February 19, 1957.

(4) Incorporated by reference to Form 10-K for the year ended September 30, 1989.

(5) Incorporated by reference to Form 10-K for the year ended September 30, 1992.

(6) Incorporated by reference to the Registrant's Form 8-K filed on February 13, 2004 and previously listed as Exhibit 2.1 in Barnwell's Form 10-QSB for the quarterly period ended March 31, 2004.

(7) Incorporated by reference to the Registrant's Form 8-K filed on February 13, 2004 and previously listed as Exhibit 2.2 in Barnwell's Form 10-QSB for the quarterly period ended March 31, 2004.

(8) Incorporated by reference to Form 10-Q for the quarterly period ended June 30, 2009.

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## SIGNATURES

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

BARNWELL INDUSTRIES, INC.

(Registrant)

By: /s/ Russell M. Gifford  
Russell M. Gifford  
Chief Financial Officer,  
Executive Vice President,  
Treasurer and Secretary  
Date: December 12, 2012

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SIGNATURES (continued)

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

/s/ Morton H. Kinzler  
Morton H. Kinzler

Chief Executive Officer and

Chairman of the Board  
Date: December 12, 2012

/s/ Russell M. Gifford  
Russell M. Gifford

Executive Vice President,

Chief Financial Officer, Treasurer,  
Secretary and Director

Date: December 12, 2012

/s/ Alexander C. Kinzler  
Alexander C. Kinzler

President, Chief Operating Officer,

General Counsel and Director

Date: December 12, 2012

/s/ Martin Anderson  
Martin Anderson, Director

Date: December 12, 2012

/s/ Murray C. Gardner  
Murray C. Gardner, Director

Date: December 12, 2012

/s/ Ahron H. Haspel  
Ahron H. Haspel, Director

/s/ Robert J. Inglima, Jr.  
Robert J. Inglima, Jr., Director

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Date: December 12, 2012

Date: December 12, 2012

/s/ Diane G. Kranz  
Diane G. Kranz, Director

/s/ Kevin K. Takata  
Kevin K. Takata, Director

Date: December 12, 2012

Date: December 12, 2012

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**INDEX TO EXHIBITS**

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