

BARNWELL INDUSTRIES INC

Form 10-Q

February 14, 2014

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended December 31, 2013**

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.)

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**1100 Alakea Street, Suite 2900, Honolulu, Hawaii**

(Address of principal executive offices)

**96813**

(Zip code)

**(808) 531-8400**

(Registrant's telephone number, including area code)

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

90 days.

Yes  No

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

required to submit and post such files).

Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

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

Act).

Yes  No

As of February 12, 2014 there were 8,277,160 shares of common stock, par value \$0.50, outstanding.

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**AND SUBSIDIARIES**

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

|  | December 31,<br>2013 | September 30,<br>2013 |
|--|----------------------|-----------------------|
| <b><u>ASSETS</u></b>   |                      |                       |
| Current assets:  |                      |                       |
| Cash and cash equivalents  | \$ 5,269,000         | \$ 7,828,000          |
| Restricted cash  | 225,000              | -                     |
| Accounts receivable, net of allowance for doubtful accounts of:<br>\$35,000 at December 31, 2013; \$43,000 at September 30, 2013 | 3,497,000            | 3,287,000             |
| Prepaid expenses   | 333,000              | 230,000               |
| Real estate held for sale  | 5,448,000            | 5,448,000             |
| Other current assets   | 2,324,000            | 2,234,000             |
| Total current assets   | 17,096,000           | 19,027,000            |
| Restricted cash, net of current portion  | 1,775,000            | -                     |
| Investments  | 7,374,000            | 2,381,000             |
| Property and equipment   | 246,641,000          | 252,872,000           |
| Accumulated depletion, depreciation, and amortization  | (206,957,000)        | (211,566,000)         |
| Property and equipment, net  | 39,684,000           | 41,306,000            |
| Total assets   | \$ 65,929,000        | \$ 62,714,000         |
| <b><u>LIABILITIES AND EQUITY</u></b>   |                      |                       |
| Current liabilities:   |                      |                       |
| Accounts payable   | \$ 3,429,000         | \$ 4,415,000          |
| Accrued capital expenditures   | 1,866,000            | 1,846,000             |
| Accrued incentive and other compensation   | 1,365,000            | 1,652,000             |
| Accrued operating and other expenses   | 3,199,000            | 2,670,000             |
| Payable to affiliate   | 1,000,000            | -                     |
| Current portion of long-term debt  | 7,106,000            | 5,240,000             |
| Other current liabilities  | 1,206,000            | 624,000               |
| Total current liabilities  | 19,171,000           | 16,447,000            |
| Long-term debt   | 13,586,000           | 11,400,000            |
| Liability for retirement benefits  | 3,218,000            | 3,137,000             |

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|  |                      |               |
|--|----------------------|---------------|
| Asset retirement obligation  | <b>7,444,000</b>     | 7,520,000     |
| Deferred income taxes  | <b>1,896,000</b>     | 1,890,000     |
| Total liabilities  | <b>45,315,000</b>    | 40,394,000    |
| Commitments and contingencies (Note 12)  |                      |               |
| Equity:  |                      |               |
| Common stock, par value \$0.50 per share; authorized, 20,000,000 shares:<br>8,445,060 issued at December 31, 2013 and September 30, 2013 | <b>4,223,000</b>     | 4,223,000     |
| Additional paid-in capital   | <b>1,291,000</b>     | 1,289,000     |
| Retained earnings  | <b>14,543,000</b>    | 15,532,000    |
| Accumulated other comprehensive income, net  | <b>2,219,000</b>     | 2,991,000     |
| Treasury stock, at cost:<br>167,900 shares at December 31, 2013 and September 30, 2013   | <b>(2,286,000)</b>   | (2,286,000)   |
| Total stockholders' equity   | <b>19,990,000</b>    | 21,749,000    |
| Non-controlling interests  | <b>624,000</b>       | 571,000       |
| Total equity   | <b>20,614,000</b>    | 22,320,000    |
| Total liabilities and equity   | <b>\$ 65,929,000</b> | \$ 62,714,000 |

See Notes to Condensed Consolidated Financial Statements

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**BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

|  | Three months ended<br>December 31, |    |                    |
|--|------------------------------------|----|--------------------|
|  | 2013                               |    | 2012               |
| Revenues:  |                                    |    |                    |
| Oil and natural gas  | \$ 5,327,000                       | \$ | 5,640,000          |
| Contract drilling  | 1,609,000                          |    | 717,000            |
| Sale of interest in leasehold land, net  | 120,000                            |    | -                  |
| Gas processing and other   | 145,000                            |    | 194,000            |
|  | <b>7,201,000</b>                   |    | <b>6,551,000</b>   |
| Costs and expenses:  |                                    |    |                    |
| Oil and natural gas operating  | 2,621,000                          |    | 1,993,000          |
| Contract drilling operating  | 1,312,000                          |    | 608,000            |
| General and administrative   | 1,856,000                          |    | 2,142,000          |
| Depletion, depreciation, and amortization  | 2,164,000                          |    | 2,679,000          |
| Reduction of carrying value of assets  | -                                  |    | 2,327,000          |
| Interest expense   | 163,000                            |    | 152,000            |
|  | <b>8,116,000</b>                   |    | <b>9,901,000</b>   |
| Loss before equity in loss of affiliates and income taxes                                | <b>(915,000)</b>                   |    | <b>(3,350,000)</b> |
| Equity in loss of affiliates   | <b>(147,000)</b>                   |    | <b>-</b>           |
| Loss before income taxes   | <b>(1,062,000)</b>                 |    | <b>(3,350,000)</b> |
| Income tax benefit   | <b>(62,000)</b>                    |    | <b>(564,000)</b>   |
| Net loss   | <b>(1,000,000)</b>                 |    | <b>(2,786,000)</b> |
| Less: Net loss attributable to non-controlling interests                                 | <b>(11,000)</b>                    |    | <b>(40,000)</b>    |
| Net loss attributable to Barnwell Industries, Inc.                                       | \$ <b>(989,000)</b>                | \$ | <b>(2,746,000)</b> |
| Basic net loss per common share attributable to Barnwell Industries, Inc. stockholders   | \$ <b>(0.12)</b>                   | \$ | <b>(0.33)</b>      |
| Diluted net loss per common share attributable to Barnwell Industries, Inc. stockholders | \$ <b>(0.12)</b>                   | \$ | <b>(0.33)</b>      |
| Weighted-average number of common shares outstanding:                                    |                                    |    |                    |
| Basic  | <b>8,277,160</b>                   |    | 8,277,160          |
| Diluted  | <b>8,277,160</b>                   |    | 8,277,160          |

See Notes to Condensed Consolidated Financial Statements



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**BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

(Unaudited)

|   | Three months ended<br>December 31, |                |
|---|------------------------------------|----------------|
|   | 2013                               | 2012           |
| Net loss  | \$ (1,000,000)                     | \$ (2,786,000) |
| Other comprehensive loss:   |                                    |                |
| Foreign currency translation adjustments, net of taxes of \$0   | (780,000)                          | (370,000)      |
| Retirement plans - amortization of accumulated other comprehensive loss into net periodic benefit cost, net of taxes of \$0 | 8,000                              | 65,000         |
| Total other comprehensive loss  | (772,000)                          | (305,000)      |
| Total comprehensive loss  | (1,772,000)                        | (3,091,000)    |
| Less: Comprehensive loss attributable to non-controlling interests  | (11,000)                           | (40,000)       |
| Comprehensive loss attributable to Barnwell Industries, Inc.  | \$ (1,761,000)                     | \$ (3,051,000) |

See Notes to Condensed Consolidated Financial Statements



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

(Unaudited)

|   | Three months ended<br>December 31, |                |
|---|------------------------------------|----------------|
|   | 2013                               | 2012           |
| Cash flows from operating activities:   |                                    |                |
| Net loss  | \$ (1,000,000)                     | \$ (2,786,000) |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                                    |                |
| Equity in loss of affiliates  | 147,000                            | -              |
| Depletion, depreciation, and amortization                                       | 2,164,000                          | 2,679,000      |
| Reduction of carrying value of assets   | -                                  | 2,327,000      |
| Retirement benefits expense   | 91,000                             | 154,000        |
| Accretion of asset retirement obligation  | 126,000                            | 96,000         |
| Deferred income tax benefit   | 67,000                             | (1,122,000)    |
| Asset retirement obligation payments  | (10,000)                           | (17,000)       |
| Share-based compensation benefit  | (175,000)                          | (32,000)       |
| Retirement plan contributions   | (1,000)                            | (251,000)      |
| Sale of interest in leasehold land, net   | (120,000)                          | -              |
| Real estate held for sale   | -                                  | (122,000)      |
| (Decrease) increase from changes in current assets and liabilities              | (290,000)                          | 817,000        |
| Net cash provided by operating activities                                       | 999,000                            | 1,743,000      |
| Cash flows from investing activities:   |                                    |                |
| Payment to acquire interest in affiliates                                       | (4,140,000)                        | -              |
| Proceeds from sale of interest in leasehold land, net of fees paid              | 120,000                            | -              |
| Proceeds from gas over bitumen royalty adjustments                              | 5,000                              | 8,000          |
| Capital expenditures - oil and natural gas                                      | (1,617,000)                        | (973,000)      |
| Capital expenditures - all other  | -                                  | (2,000)        |
| Net cash used in investing activities   | (5,632,000)                        | (967,000)      |
| Cash flows from financing activities:   |                                    |                |
| Proceeds from long-term debt borrowings   | 4,186,000                          | 502,000        |
| Repayments of long-term debt  | (134,000)                          | (129,000)      |
| Increase in restricted cash   | (2,000,000)                        | -              |
| Contributions from non-controlling interests                                    | 64,000                             | 55,000         |
| Net cash provided by financing activities                                       | 2,116,000                          | 428,000        |
| Effect of exchange rate changes on cash and cash equivalents                    | (42,000)                           | (22,000)       |
| Net (decrease) increase in cash and cash equivalents                            | (2,559,000)                        | 1,182,000      |
| Cash and cash equivalents at beginning of period                                | 7,828,000                          | 8,845,000      |
| Cash and cash equivalents at end of period                                      | \$ 5,269,000                       | \$ 10,027,000  |



Table of Contents**BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF EQUITY****Three months ended December 31, 2013 and 2012**

(Unaudited)

|  | 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, 2012</b>   | 8,277,160             | \$ 4,223,000        | \$ 1,289,000                     | \$ 24,095,000        | \$ 2,322,000                                    | \$ (2,286,000)        | \$ 482,000                   | \$ 30,125,000        |
| Contributions from<br>non-controlling interests  |                       |                     |                                  |                      |   |                       | 55,000                       | 55,000               |
| Net loss   |                       |                     |                                  | (2,746,000)          |   |                       | (40,000)                     | (2,786,000)          |
| Foreign currency<br>translation adjustments,<br>net of taxes of \$0  |                       |                     |                                  |                      | (370,000)                                       |                       |                              | (370,000)            |
| Retirement plans -<br>amortization of<br>accumulated other<br>comprehensive loss into<br>net periodic benefit cost,<br>net of taxes of \$0 |                       |                     |                                  |                      | 65,000  |                       |                              | 65,000               |
| <b>Balance at<br/>December 31, 2012</b>  | 8,277,160             | \$ 4,223,000        | \$ 1,289,000                     | \$ 21,349,000        | \$ 2,017,000                                    | \$ (2,286,000)        | \$ 497,000                   | \$ 27,089,000        |
| <b>Balance at<br/>September 30, 2013</b>   | 8,277,160             | \$ 4,223,000        | \$ 1,289,000                     | \$ 15,532,000        | \$ 2,991,000                                    | \$ (2,286,000)        | \$ 571,000                   | \$ 22,320,000        |
| Contributions from<br>non-controlling interests  |                       |                     |                                  |                      |   |                       | 64,000                       | 64,000               |
| Net loss   |                       |                     |                                  | (989,000)            |   |                       | (11,000)                     | (1,000,000)          |
| Share-based<br>compensation  |                       |                     | 2,000                            |                      |   |                       |                              | 2,000                |
| Foreign currency<br>translation adjustments,<br>net of taxes of \$0  |                       |                     |                                  |                      | (780,000)                                       |                       |                              | (780,000)            |
| Retirement plans -<br>amortization of<br>accumulated other<br>comprehensive loss into<br>net periodic benefit cost,<br>net of taxes of \$0 |                       |                     |                                  |                      | 8,000   |                       |                              | 8,000                |
| <b>Balance at<br/>December 31, 2013</b>  | <b>8,277,160</b>      | <b>\$ 4,223,000</b> | <b>\$ 1,291,000</b>              | <b>\$ 14,543,000</b> | <b>\$ 2,219,000</b>                             | <b>\$ (2,286,000)</b> | <b>\$ 624,000</b>            | <b>\$ 20,614,000</b> |

See Notes to Condensed Consolidated Financial Statements

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**BARNWELL INDUSTRIES, INC.**

**AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Principles of Consolidation*

The condensed 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 77.6%-owned land investment general partnership (Kaupulehu Developments), a 75%-owned land investment partnership (KD Kona 2013 LLLP) and two 80%-owned joint ventures (Kaupulehu 2007, LLLP and Kaupulehu Investors, LLC). All significant intercompany accounts and transactions have been eliminated.

Barnwell's investments in both unconsolidated entities in which a significant, but less than controlling, interest is held and in variable interest entities ( VIE ) in which the Company is not deemed to be the primary beneficiary are accounted for by the equity method.

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

*Unaudited Interim Financial Information*

The accompanying unaudited condensed consolidated financial statements and notes have been prepared by Barnwell in accordance with the rules and regulations of the United States ( U.S. ) Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. These condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in Barnwell's September 30, 2013

Annual Report on Form 10-K. The Condensed Consolidated Balance Sheet as of September 30, 2013 has been derived from audited consolidated financial statements.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at December 31, 2013, results of operations, comprehensive loss, cash flows and equity for the three months ended December 31, 2013 and 2012, have been made. The results of operations for the period ended December 31, 2013 are not necessarily indicative of the operating results for the full year.

*Use of Estimates*

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.

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*Significant Accounting Policies*

Other than as set forth below, there have been no changes to Barnwell's significant accounting policies as described in the Notes to Consolidated Financial Statements included in Item 8 of the Company's most recently filed Annual Report on Form 10-K.

*Restricted Cash*

Restricted cash consists of deposits for interest reserve and collateral for our land investment loan.

*Equity Method Investments*

Affiliated companies, which are limited partnerships or similar entities, in which Barnwell holds more than a 3 to 5% ownership interest, are accounted for as equity method investments. Equity method investment adjustments include Barnwell's proportionate share of investee income or loss, adjustments to recognize certain differences between Barnwell's carrying value and Barnwell's equity in net assets of the investee at the date of investment, impairments, and other adjustments required by the equity method. Gain or losses are realized when such investments are sold.

Investments in equity method investees are evaluated for impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the carrying amounts of the assets exceed their respective fair values, additional impairment tests are performed to measure the amounts of the impairment losses, if any. When an impairment test demonstrates that the fair value of an investment is less than its carrying value, management will determine whether the impairment is either temporary or other-than-temporary. Examples of factors which may be indicative of an other-than-temporary impairment include (i) the length of time and extent to which fair value has been less than carrying value, (ii) the financial condition and near-term prospects of the investee, and (iii) the intent and ability to retain the investment in the investee for a period of time sufficient to allow for any anticipated recovery in fair value. If the decline in fair value is determined by management to be other-than-temporary, the carrying value of the investment is written down to its estimated fair value as of the balance sheet date of the reporting period in which the assessment is made.

*Variable Interest Entities*

The consolidation of VIEs is required when an enterprise has a controlling financial interest and is therefore the VIE's primary beneficiary. A controlling financial interest will have both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (b) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. The determination of whether an entity is a VIE and, if so, whether the Company is primary beneficiary, may require significant judgment.

Barnwell analyzes its unconsolidated affiliates in which it has an investment to determine whether the unconsolidated entities are VIEs and, if so, whether the Company is the primary beneficiary. This analysis includes a qualitative review based on an evaluation of the design of the entity, its organizational structure, including decision making ability and financial agreements, as well as a quantitative review. At December 31, 2013, our unconsolidated affiliates that have been determined to be VIEs are accounted under the equity method because we do not have a controlling financial interest and are therefore not the VIE's primary beneficiary (see Note 5).

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In February 2013, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. The Company adopted the provisions of this ASU effective October 1, 2013. The adoption of this ASU impacted the presentation of Barnwell s accumulated other comprehensive income footnote disclosures.

## 2. LOSS PER COMMON SHARE

Basic earnings (loss) per share excludes dilution and is computed by dividing net earnings (loss) attributable to Barnwell stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings (loss) per share includes the potentially dilutive effect of outstanding common stock options, to the extent their inclusion would be dilutive. Potentially dilutive shares are excluded from the computation of diluted earnings (loss) per share if their effect is anti-dilutive.

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. Options to purchase 837,250 and 807,250 shares of common stock were excluded from the computation of diluted shares for the three months ended December 31, 2013 and 2012, respectively, as their inclusion would have been antidilutive due to the net loss attributable to Barnwell stockholders.

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:

|                          | Three months ended December 31, 2013 |                         |                     |
|--------------------------|--------------------------------------|-------------------------|---------------------|
|                          | Net Loss<br>(Numerator)              | Shares<br>(Denominator) | Per-Share<br>Amount |
| Basic net loss per share | \$ (989,000)                         | 8,277,160               | \$ (0.12)           |



Effect of dilutive securities - common  
stock options

-

-

Diluted net loss per share

\$ (989,000)

8,277,160

\$ (0.12)

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|   | Three months ended December 31, 2012 |                         |                     |
|---|--------------------------------------|-------------------------|---------------------|
|   | Net Loss<br>(Numerator)              | Shares<br>(Denominator) | Per-Share<br>Amount |
| Basic net loss per share                                | \$ (2,746,000)                       | 8,277,160               | \$ (0.33)           |
| Effect of dilutive securities - common<br>stock options | -                                    | -                       |                     |
| Diluted net loss per share                              | \$ (2,746,000)                       | 8,277,160               | \$ (0.33)           |

**3. SHARE-BASED PAYMENTS**

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

|                                  | Three months ended<br>December 31, |             |
|----------------------------------|------------------------------------|-------------|
|                                  | 2013                               | 2012        |
| Share-based compensation benefit | \$ (175,000)                       | \$ (32,000) |
| Income tax effect                | \$ -                               | \$ -        |

Share-based compensation benefit recognized in loss for the three months ended December 31, 2013 and 2012 are reflected in General and administrative expenses in the Condensed Consolidated Statements of Operations. There was no impact on income taxes for the three months ended December 31, 2013 and 2012 due to a full valuation allowance on the related deferred tax asset.

As of December 31, 2013, there was \$119,000 of total unrecognized compensation cost related to nonvested share options. That cost is expected to be recognized over 3.9 years. The weighted-average grant date fair value of employee options granted during the three months ended December 31, 2013 was \$2.04 (no options were granted during the three months ended December 31, 2012).

*Equity-classified Awards*

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In December 2013, 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 four years of continuous service, and that expire ten years from the date of grant.

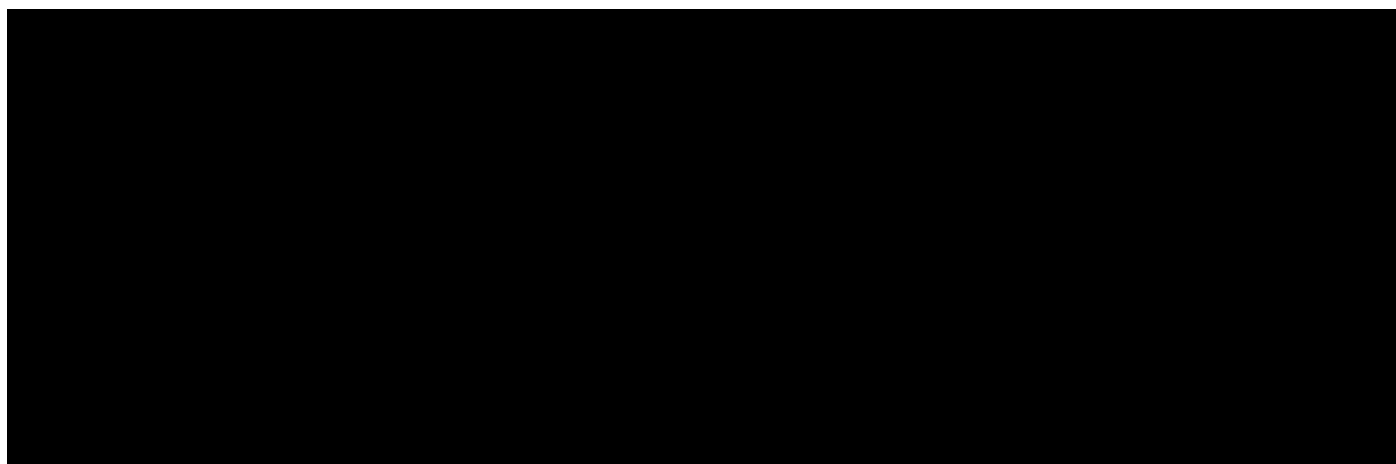
The following assumptions were used in estimating fair value for equity-classified share options granted in the three months ended December 31, 2013:

|                          |       |
|--------------------------|-------|
| Expected volatility      | 55.6% |
| Expected dividends       | 0.0%  |
| Expected term (in years) | 10    |
| Risk-free interest rate  | 3.0%  |
| Expected forfeitures     | None  |

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

A summary of the activity in Barnwell's equity-classified share options from October 1, 2013 through December 31, 2013 is presented below:



Total share-based compensation expense for equity-classified awards vested in the three months ended December 31, 2013 and 2012 was \$2,000 and \$0, respectively.

*Liability-classified Awards*

In December 2013, 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 four 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.

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

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Three months ended December 31,  
2013 2012

|                             |                |                |
|-----------------------------|----------------|----------------|
| Expected volatility range   | 49.4% to 62.6% | 32.6% to 66.1% |
| Weighted-average volatility | 56.5%          | 59.0%          |
| Expected dividends          | 0.0%           | 0.0%           |
| Expected term (in years)    | 0.9 to 10.0    | 0.2 to 7.0     |
| Risk-free interest rate     | 0.1% to 3.0%   | 0.1% to 1.2%   |
| Expected forfeitures        | None           | None           |

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

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A summary of the activity in Barnwell's liability-classified share options from October 1, 2013 through December 31, 2013 is presented below:

| Options                          | Shares  | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|----------------------------------|---------|---------------------------------|--|---------------------------|
| Outstanding at October 1, 2013   | 717,250 | \$ 8.37                         |  |                           |
| Granted                          | 30,000  | 3.01                            |  |                           |
| Exercised                        | -       |                                 |  |                           |
| Expired/Forfeited                | -       |                                 |  |                           |
| Outstanding at December 31, 2013 | 747,250 | \$ 8.15                         | 4.4  | \$ -                      |
| Exercisable at December 31, 2013 | 639,750 | \$ 8.86                         | 3.9  | \$ -                      |

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

|   | Three months ended December 31, |             |
|---|---------------------------------|-------------|
|   | 2013                            | 2012        |
| Due to vesting  | \$ 7,000                        | \$ 18,000   |
| Due to remeasurement  | (184,000)                       | (50,000)    |
| Total share-based compensation benefit for liability-based awards | \$ (177,000)                    | \$ (32,000) |

#### 4. REAL ESTATE HELD FOR SALE

Kaupulehu 2007, LLLP ( Kaupulehu 2007 ) currently owns one luxury residence that is available for sale in the Lot 4A Increment I area located in the North Kona District of the island of Hawaii, north of Hualalai Resort at Historic Ka`upulehu, between the Queen Kaahumanu Highway and the Pacific Ocean.



Table of Contents**5. INVESTMENTS**

A summary of Barnwell's investments is as follows:

|  | <b>December 31,<br/>2013</b> | September 30,<br>2013 |
|--|------------------------------|-----------------------|
| Investment in two residential parcels          | \$ 2,331,000                 | \$ 2,331,000          |
| Investment in land development partnerships    | 4,993,000                    | -                     |
| Investment in leasehold land interest - Lot 4C | 50,000                       | 50,000                |
| Total investments                              | \$ 7,374,000                 | \$ 2,381,000          |

*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.

*Investment in land development partnerships*

On November 27, 2013, Barnwell, through a wholly-owned subsidiary, entered into two limited liability limited partnerships, KD Kona 2013 LLLP and KKM Makai, LLLP, and indirectly acquired a 19.6% ownership interest in each WB Kukio Resorts, LLC, WB Maniniowali, LLC, and WB Kaupulehu, LLC for \$5,140,000. These entities own certain real estate and development rights interests in the Kukio, Maniniowali, and Kaupulehu portions of Kukio Resort, a private residential community on the Kona coast of the island of Hawaii. WB Kaupulehu, LLC, which is comprised of WB KD Acquisition, LLC (WB) and WB KD Acquisition II, LLC (WBKD), is the developer of Kaupulehu Lot 4A Increments I and II, the area in which Barnwell has interests in percentage of sales payments. Barnwell's investment in these entities is accounted for using the equity method of accounting.

The limited liability limited partnership agreements provide for a priority return of Barnwell's investment prior to profit distributions. Net profits, losses and cash flows of the partnerships are allocated to Barnwell and the other partners at varying percentages based on whether the initial and any additional capital contributions have been repaid to the investors. For the period from the acquisition date, November 27, 2013, to December 31, 2013, Barnwell was allocated partnership losses of \$147,000.



Barnwell, through affiliated entities, borrowed approximately \$4,140,000 on the acquisition date under a new bank loan to partially fund the acquisition. In January 2014, Barnwell paid an additional \$1,000,000, of which approximately \$814,000 was borrowed under the new bank loan, to fund the remainder of the acquisition price. This amount is accrued under the caption Payable to affiliate in the Condensed Consolidated Balance Sheets at December 31, 2013.

The initial accounting for the acquisition by the general partner of the investees is incomplete as the general partner is currently in the process of performing an acquisition date audit. As such, we are unable to determine the amount, if any, of the basis difference between the underlying equity in net assets of the investee land development partnerships and the carrying value of Barnwell's investment as a limited partner.

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Barnwell, as well as WB and certain other owners of the partnership, have jointly and severally executed a surety indemnification agreement. Bonds issued by the surety at December 31, 2013 totaled approximately \$4,700,000 and relate to certain construction contracts of WB. If any such performance bonds are called, we may be obligated to reimburse the issuer of the performance bond as Barnwell, WB and certain other owners are jointly and severally liable, however we believe that it is remote that a material amount of any currently outstanding performance bonds will be called. Performance bonds do not have stated expiration dates. Rather, the performance bonds are released as the underlying performance is completed.

As of December 31, 2013, Barnwell's maximum loss exposure as a result of its investment in the land development partnerships was \$9,693,000, consisting of the carrying value of the investment of \$4,993,000 and \$4,700,000 from the surety indemnification agreement of which we are jointly and severally liable.

Summarized financial information for the land development partnerships is as follows for the period of November 27, 2013 to December 31, 2013:

|                      |                     |
|----------------------|---------------------|
| Revenue              | <b>\$ 269,000</b>   |
| Gross profit         | <b>\$ 211,000</b>   |
| Loss from operations | <b>\$ (386,000)</b> |
| Net loss             | <b>\$ (381,000)</b> |

*Percentage of sales payments*

Kaupulehu Developments has the right to receive payments resulting from the sale of lots and/or residential units within approximately 870 acres of the Kaupulehu Lot 4A area in two increments ( Increment I and Increment II ).

The following table summarizes the Increment I percentage of sales payment revenues received during the three months ended December 31, 2013 (no amounts were received during the three months ended December 31, 2012). This sale occurred prior to our purchase of an ownership interest in the land development partnerships:

|  |                   |
|--|-------------------|
| Sale of interest in leasehold land:              |                   |
| Proceeds   | <b>\$ 140,000</b> |
| Fees   | <b>(20,000)</b>   |
| Revenues sale of interest in leasehold land, net | <b>\$ 120,000</b> |

*Investment in leasehold land interest - Lot 4C*

Kaupulehu Developments holds an interest in an area of approximately 1,000 acres of vacant leasehold land zoned conservation located adjacent to Lot 4A. The lease terminates in December 2025.

Table of Contents**6. LONG-TERM DEBT**

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

|                                    | <b>December 31,<br/>2013</b> | September 30,<br>2013 |
|------------------------------------|------------------------------|-----------------------|
| Canadian revolving credit facility | \$ <b>12,000,000</b>         | \$ 12,000,000         |
| Real estate loan                   | <b>4,506,000</b>             | 4,640,000             |
| Land investment loan               | <b>4,186,000</b>             | -                     |
|                                    | <b>20,692,000</b>            | 16,640,000            |
| Less: current portion              | <b>(7,106,000)</b>           | (5,240,000)           |
| Total long-term debt               | \$ <b>13,586,000</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\$18,804,000 at the December 31, 2013 exchange rate. Unused credit available under this facility was US\$6,804,000 and the interest rate on the facility was 2.66% at December 31, 2013.

Under the financing agreement with Royal Bank of Canada, the facility is reviewed annually, with the next review planned for April 2014. 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 2014, Barnwell would be obligated to make quarterly principal and interest repayments beginning in July 2014. As such, two quarterly repayments of 5% each would be due within one year of December 31, 2013 and accordingly, we have included \$1,200,000, representing 10% of the outstanding loan balance at December 31, 2013, in the current portion of long-term debt.

*Real estate loan*

Barnwell, together with its real estate joint venture, Kaupulehu 2007, has a non-revolving real estate loan with a Hawaii bank. Principal and interest are paid monthly and are determined based on a loan amortization schedule. The monthly payment will change as a result of an annual change in the interest rate, the sale of the 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 December 31, 2013 was 3.53%. 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 the 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.

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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.

The home collateralizing the loan is currently available for sale; therefore, the entire balance outstanding at December 31, 2013 under the term loan has been classified as a current liability.

*Land investment loan*

On November 27, 2013, Barnwell, through affiliated entities, entered into a non-revolving loan with a Hawaii bank for \$5,000,000 and borrowed approximately \$4,186,000 on the loan to partially fund the acquisition of interests in the land development partnerships and certain acquisition costs. In January 2014, an additional \$814,000 was borrowed on the loan to partially fund the remainder of the acquisition price, bringing the total borrowings under the land investment loan to the facility maximum of \$5,000,000.

The bank loan matures in December 2015, with an option to extend one year, and accrues interest for the first year at 4.5% and resets annually thereafter to the lender's then prevailing interest rate for similarly priced commercial mortgage loans or to the lender's base rate plus 0.50%. The interest rate at December 31, 2013 was 4.50%. Principal payments are due on the receipt of percentage of sales payments from the sale of lots within Kaupulehu Lot 4A Increments I and II, upon the sale of Kaupulehu 2007's residential parcels and on receipt of cash distributions from the land development partnerships. Additionally, Kaupulehu 2007 will be required to make a principal payment of \$1,400,000 upon the sale of the real estate held for sale; therefore, \$1,400,000 has been classified as a current liability.

The loan is collateralized by Kaupulehu Developments' rights to percentage of sales payments from the sale of lots within Kaupulehu Lot 4A Increments I and II, a second mortgage on Kaupulehu 2007's lots together with all improvements thereon, the interest in the land development partnerships and any distributions from the partnerships, a \$1,000,000 interest reserve account and a \$1,000,000 pledged deposit account. Barnwell is a guarantor of the loan.

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.

7. **RETIREMENT PLANS**

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

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The following table details the components of net periodic benefit cost for Barnwell's retirement plans:

|   | Pension Plan |           | SERP                            |           | Postretirement Medical |           |
|---|--------------|-----------|---------------------------------|-----------|------------------------|-----------|
|   | 2013         | 2012      | Three months ended December 31, |           | 2013                   | 2012      |
|   |              |           | 2013                            | 2012      |                        |           |
| Service cost                                | \$ 59,000    | \$ 68,000 | \$ 12,000                       | \$ 13,000 | \$ 3,000               | \$ 4,000  |
| Interest cost                               | 85,000       | 75,000    | 16,000                          | 14,000    | 13,000                 | 12,000    |
| Expected return on plan assets              | (105,000)    | (97,000)  | -                               | -         | -                      | -         |
| Amortization of prior service cost (credit) | 1,000        | 1,000     | (1,000)                         | (1,000)   | 3,000                  | 34,000    |
| Amortization of net actuarial loss (gain)   | 9,000        | 26,000    | 1,000                           | 5,000     | (5,000)                | -         |
| Net periodic benefit cost                   | \$ 49,000    | \$ 73,000 | \$ 28,000                       | \$ 31,000 | \$ 14,000              | \$ 50,000 |

Barnwell estimates that it will make approximately \$600,000 in contributions to the Pension Plan during fiscal 2014. 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 2014 and expected payments under the SERP for fiscal 2014 are not material. Fluctuations in actual equity 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.

## 8. INCOME TAXES

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

|               | Three months ended<br>December 31, |                |
|---------------|------------------------------------|----------------|
|               | 2013                               | 2012           |
| United States | \$ (850,000)                       | \$ (1,288,000) |
| Canada        | (201,000)                          | (2,022,000)    |
|               | \$ (1,051,000)                     | \$ (3,310,000) |

The components of the income tax benefit are as follows:



|          | Three months ended<br>December 31, |              |
|----------|------------------------------------|--------------|
|          | 2013                               | 2012         |
| Current  | \$ (129,000)                       | \$ 558,000   |
| Deferred | 67,000                             | (1,122,000)  |
|          | \$ (62,000)                        | \$ (564,000) |

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Barnwell's effective consolidated income tax benefit rate for the three months ended December 31, 2013 and 2012, after adjusting loss before income taxes for non-controlling interests, was 6% and 17%, respectively.

Consolidated taxes do not bear a customary relationship to pretax losses due primarily 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 any future U.S. tax benefit prior to expiration.

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

Table of Contents**9. SEGMENT 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).

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.

|   | Three months ended<br>December 31, |                |
|---|------------------------------------|----------------|
|   | 2013                               | 2012           |
| Revenues:   |                                    |                |
| Oil and natural gas   | \$ 5,327,000                       | \$ 5,640,000   |
| Land investment   | 120,000                            | -              |
| Contract drilling   | 1,609,000                          | 717,000        |
| Other   | 141,000                            | 166,000        |
| Total before interest income  | 7,197,000                          | 6,523,000      |
| Interest income   | 4,000                              | 28,000         |
| Total revenues  | \$ 7,201,000                       | \$ 6,551,000   |
| Depletion, depreciation, and amortization:                            |                                    |                |
| Oil and natural gas   | \$ 2,059,000                       | \$ 2,535,000   |
| Contract drilling   | 78,000                             | 115,000        |
| Other   | 27,000                             | 29,000         |
| Total depletion, depreciation, and amortization                       | \$ 2,164,000                       | \$ 2,679,000   |
| Reduction of carrying value of assets:                                |                                    |                |
| Oil and natural gas   | \$ -                               | \$ 2,327,000   |
| Operating profit (loss) (before general and administrative expenses): |                                    |                |
| Oil and natural gas   | \$ 647,000                         | \$ (1,215,000) |
| Land investment   | 120,000                            | -              |
| Contract drilling   | 219,000                            | (6,000)        |
| Other   | 114,000                            | 137,000        |
| Total operating profit (loss)   | 1,100,000                          | (1,084,000)    |
| Equity in loss of affiliates:   |                                    |                |

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|                                     |                       |                       |
|-------------------------------------|-----------------------|-----------------------|
| Land investment                     | <b>(147,000)</b>      | -                     |
| General and administrative expenses | <b>(1,856,000)</b>    | (2,142,000)           |
| Interest expense                    | <b>(163,000)</b>      | (152,000)             |
| Interest income                     | <b>4,000</b>          | 28,000                |
| Loss before income taxes            | <b>\$ (1,062,000)</b> | <b>\$ (3,350,000)</b> |

Table of Contents*Assets By Segment:*

|                             | <b>December 31,<br/>2013</b> | September 30,<br>2013 |
|-----------------------------|------------------------------|-----------------------|
| Oil and natural gas (1)     | \$ <b>39,148,000</b>         | \$ 40,559,000         |
| Land investment (2)         | <b>7,374,000</b>             | 2,381,000             |
| Contract drilling (2)       | <b>3,114,000</b>             | 2,905,000             |
| Residential real estate (2) | <b>5,448,000</b>             | 5,448,000             |
| Other:                      |                              |                       |
| Cash and cash equivalents   | <b>5,269,000</b>             | 7,828,000             |
| Restricted cash             | <b>2,000,000</b>             | -                     |
| Corporate and other         | <b>3,576,000</b>             | 3,593,000             |
| Total                       | <b>\$ 65,929,000</b>         | \$ 62,714,000         |

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

(2) Located in Hawaii.

## 10. ACCUMULATED OTHER COMPREHENSIVE INCOME

The changes in each component of accumulated other comprehensive income (loss) were as follows:

|  | Three months ended<br>December 31, |              |
|--|------------------------------------|--------------|
|  | 2013                               | 2012         |
| Foreign currency translation:                        |                                    |              |
| Beginning accumulated foreign currency translation   | \$ <b>3,701,000</b>                | \$ 5,020,000 |
| Change in cumulative translation adjustment          | <b>(780,000)</b>                   | (370,000)    |
| Income taxes   | -                                  | -            |
| Ending accumulated foreign currency translation      | <b>2,921,000</b>                   | 4,650,000    |
| Retirement plans:                                    |                                    |              |
| Beginning accumulated retirement plans benefit cost  | <b>(710,000)</b>                   | (2,698,000)  |
| Amortization of prior service cost                   | <b>3,000</b>                       | 34,000       |
| Amortization of net actuarial loss                   | <b>5,000</b>                       | 31,000       |
| Income taxes   | -                                  | -            |
| Ending accumulated retirement plans benefit cost     | <b>(702,000)</b>                   | (2,633,000)  |
| Accumulated other comprehensive income, net of taxes | <b>\$ 2,219,000</b>                | \$ 2,017,000 |

The accumulated other comprehensive loss components for the retirement plans are included in the computation of net periodic benefit cost which is a component of general and administrative expenses on the accompanying Condensed Consolidated Statement of Operations (see Note 7 for additional details).

Table of Contents**11. FAIR VALUE MEASUREMENTS***Fair Value of Financial Instruments*

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued current liabilities 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.

**12. COMMITMENTS AND CONTINGENCIES***Environmental Matters*

As of December 31, 2013 and September 30, 2013, environmental remediation costs of \$781,000 and \$783,000, respectively, which have not been discounted, were accrued in Accrued operating and other expenses on the Condensed Consolidated Balance Sheets. The amounts accrued represent the estimated liability for probable environmental remediation costs for soil contamination from infrastructure issues at the Dunvegan and Wood River properties. Because of the inherent uncertainties associated with environmental assessment and remediation activities, future expenses to remediate the currently identified sites, and sites identified in the future, if any, could be incurred.

**13. INFORMATION RELATING TO THE CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | Three months ended December 31, |            |
|---|---------------------------------|------------|
|   | 2013                            | 2012       |
| Supplemental disclosure of cash flow information: |                                 |            |
| Cash paid during the year for:                    |                                 |            |
| Interest  | \$ 138,000                      | \$ 146,000 |
| Income taxes (refunded) paid                      | \$ (78,000)                     | \$ 5,000   |

Supplemental disclosure of non-cash investing and financing activities:

|  |    |                  |    |   |
|--|----|------------------|----|---|
| Payable to affiliate for investment in land development partnerships | \$ | <b>1,000,000</b> | \$ | - |
|--|----|------------------|----|---|

Capital expenditure accruals related to oil and natural gas exploration and development increased \$82,000 and \$844,000 during the three months ended December 31, 2013 and 2012, respectively. Additionally, during the three months ended December 31, 2013 and 2012, capital expenditure accruals related to oil and natural gas asset retirement obligations increased \$57,000 and \$48,000, respectively.



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**14. OIL AND NATURAL GAS PROPERTIES**

Under the full cost method of accounting, the Company performs quarterly ceiling test calculations. Barnwell's net capitalized costs exceeded the ceiling limitation at December 31, 2012. As such, Barnwell reduced the carrying value of its oil and natural gas properties by \$2,327,000 during the three months ended December 31, 2012. No such reduction was necessary during the three months ended December 31, 2013. The reduction is included in the Condensed Consolidated Statements of Operations under the caption Reduction of carrying value of assets.

**15. SUBSEQUENT EVENT**

In January 2014, Barnwell paid \$1,000,000 to fund the remainder of the acquisition price for the land development partnership interests purchased in November 2013. This amount is accrued under the caption Payable to affiliate in the Condensed Consolidated Balance Sheets at December 31, 2013. An additional \$814,000 was borrowed on the land investment loan to partially fund the remainder of the acquisition price, bringing the total borrowings under the land investment loan to the facility maximum of \$5,000,000.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**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-Q, 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's 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. The risks, uncertainties and other factors that might cause actual results to differ materially from Barnwell's expectations are set forth in the Forward-Looking Statements and Risk Factors sections of Barnwell's Annual Report on Form 10-K for the year ended September 30, 2013. 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-Q, and Barnwell expressly disclaims any obligation or undertaking to publicly release any updates or revisions to any forward-looking statements contained herein.*

**Critical Accounting Policies and Estimates**

Management has determined that our most critical accounting policies and estimates are those related to the evaluation of recoverability of assets, depletion of our oil and natural gas properties, income taxes and asset retirement obligation which are discussed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. There have been no significant changes to these critical accounting policies and estimates during the three months ended December 31, 2013. We continue to monitor our accounting policies to ensure proper application of current rules and regulations.

### **Impact of Recently Issued Accounting Standards on Future Filings**

In February 2013, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date. This update provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. Examples of obligations within this guidance are debt arrangements, other contractual obligations, and settled litigation and judicial rulings. The amendments are effective retrospectively for fiscal years, and interim reporting periods within those years, beginning after December 15, 2013. The adoption of this update is not expected to have a material impact on Barnwell s consolidated financial statements.

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In March 2013, the FASB issued ASU No. 2013-05, *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*. This update provides guidance on releasing cumulative translation adjustments when a reporting entity ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. In addition, these amendments provide guidance on the release of cumulative translation adjustments in partial sales of equity method investments and in step acquisitions. The amendments are effective on a prospective basis for fiscal years, and interim reporting periods within those years, beginning after December 15, 2013. The adoption of this update is not expected to have a material impact on Barnwell's consolidated financial statements.

In April 2013, the FASB issued ASU No. 2013-07, *Liquidation Basis of Accounting*, which provides guidance on when and how to apply the liquidation basis of accounting and on what to disclose. The update requires an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent, as defined in the update. The amendments are effective on a prospective basis for an entity that determines liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. The adoption of this update is not expected to have a material impact on Barnwell's consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, which requires an entity to present an unrecognized tax benefit as a reduction of a deferred tax asset for an net operating loss (NOL) carryforward, or similar tax loss or tax credit carryforward, rather than as a liability when (1) the uncertain tax position would reduce the NOL or other carryforward under the tax law of the applicable jurisdiction and (2) the entity intends to use the deferred tax asset for that purpose. The amendments are effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this update is not expected to have a material impact on Barnwell's consolidated financial statements.

## **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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*Land Investment Segment*

The land investment segment is comprised of the following components:

1) Through Barnwell's 77.6% controlling interest in Kaupulehu Developments, a Hawaii general partnership, 75% controlling interest in KD Kona 2013 LLLP, a Hawaii limited liability limited partnership, and 34.45% non-controlling interest in KKM Makai, LLLP, a Hawaii limited liability limited partnership, the Company's land investment interests include the following:

- The right to receive payments from WB KD Acquisition, LLC ( WB ) and WB KD Acquisition II, LLC ( WBKD ), resulting from the sale of lots and/or residential units within approximately 870 acres of the Kaupulehu Lot 4A area, 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, by WB and WBKD in two increments ( Increment I and Increment II ). Increment I is an area zoned for approximately 80 single-family lots and a beach club on the portion of the property bordering the Pacific Ocean, and is partially developed. The purchasers of the 80 single-family lots will have the right to apply for membership in the Kuki'o Golf and Beach Club, which is located adjacent to and south of the Hualalai Resort at Historic Kaupulehu. Increment II is the remaining portion of the approximately 870-acre property, is zoned for single-family and multi-family residential units and a golf course and clubhouse, and is not yet developed.
- A 19.6% ownership interest in each WB Kukio Resorts, LLC, WB Maniniowali, LLC, and WB Kaupulehu, LLC. These entities own certain real estate and development rights interests in the Kukio, Maniniowali, and Kaupulehu portions of Kukio Resort, a private residential community on the Kona coast of the island of Hawaii. WB Kaupulehu, LLC, which wholly owns WB and WBKD, is the developer of Kaupulehu Lot 4A Increments I and II, the area in which Barnwell has interests in percentage of sales payments.
- 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.

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

*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.

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**Results of Operations**

*Summary*

Barnwell incurred a net loss of \$989,000 for the three months ended December 31, 2013, a \$1,757,000 increase in operating results from a net loss of \$2,746,000 for the three months ended December 31, 2012. The following factors affected the results of operations for the three months ended December 31, 2013 as compared to the prior year period:

- There was a reduction of the carrying value of oil and natural gas properties of \$2,327,000 in the prior year period and there was no such reduction in the three month period ended December 31, 2013;
- A \$225,000 increase in contract drilling operating results, before taxes, primarily resulting from increased water well drilling activity and higher contract margins on water well drilling; and
- A \$465,000 decrease in oil and natural gas segment operating profit, before the prior year reduction in carrying value of assets and taxes, primarily resulting from lower net production for all products and higher operating costs due to an increase in repairs and workovers.

*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 6% in the three months ended December 31, 2013, as compared to the same period in the prior year, and the exchange rate of the Canadian dollar to the U.S. dollar decreased 3% at December 31, 2013, as compared to September 30, 2013. 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. Other comprehensive loss due to foreign currency translation adjustments, net of taxes, for the three months ended December 31, 2013 was \$780,000, a \$410,000 change from other comprehensive loss due to foreign currency translation adjustments, net of taxes, of \$370,000 for the same period in the prior year. There were no taxes on other comprehensive loss due to foreign currency translation adjustments in the three months ended December 31, 2013 and 2012 due to a full valuation allowance on the related deferred tax asset.

Table of Contents*Oil and natural gas revenues*

The following tables set forth Barnwell's average prices per unit of production and net production volumes. Production amounts reported are net of royalties.

|                    | Average Price Per Unit |          |           |            |      |
|--------------------|------------------------|----------|-----------|------------|------|
|                    | Three months ended     |          |           | Increase   |      |
|                    | December 31,           |          |           | (Decrease) |      |
|                    | 2013                   | 2012     | \$        |            | %    |
| Natural Gas (Mcf)* | \$ 2.99                | \$ 2.53  | \$ 0.46   |            | 18%  |
| Oil (Bbls)**       | \$ 72.96               | \$ 75.00 | \$ (2.04) |            | (3%) |
| Liquids (Bbls)**   | \$ 43.70               | \$ 40.29 | \$ 3.41   |            | 8%   |

|                    | Net Production     |         |            |       |
|--------------------|--------------------|---------|------------|-------|
|                    | Three months ended |         | Increase   |       |
|                    | December 31,       |         | (Decrease) |       |
|                    | 2013               | 2012    | Units      | %     |
| Natural Gas (Mcf)* | 553,000            | 660,000 | (107,000)  | (16%) |
| Oil (Bbls)**       | 37,000             | 38,000  | (1,000)    | (3%)  |
| Liquids (Bbls)**   | 19,000             | 24,000  | (5,000)    | (21%) |

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\* Mcf = 1,000 cubic feet. Natural gas price per unit is net of pipeline charges.

\*\* Bbl = stock tank barrel equivalent to 42 U.S. gallons

Oil and natural gas revenues decreased \$313,000 (6%) for the three months ended December 31, 2013, as compared to the same period in the prior year, as the impact of higher prices for natural gas was more than offset by the impact of lower net production for all products.

Net natural gas production for the three months ended December 31, 2013 decreased 16%, as compared to the same period in the prior year largely due to natural declines in production from older properties.

Net natural gas liquids production decreased as compared to the same period in the prior year due to natural declines in production.

*Oil and natural gas operating expenses*

Oil and natural gas operating expenses increased \$628,000 (32%) for the three months ended December 31, 2013, as compared to the same period in the prior year, primarily due to increased repair and maintenance costs which are trending higher as the average age of our properties increases, approximately \$150,000 in repair work at a major oil battery in the Red Earth area and \$50,000 in costs to eliminate a drilling commitment. Additionally, equalization credits of \$26,000 for previously allocated operating expenses were received from non-operated properties in the current year period as compared to \$220,000 in equalization credits received in the prior year period. Oil and natural gas operating expenses generally increase over time on a per unit basis as properties age and as more remedial repairs and maintenance are required.

Table of Contents*Sale of interest in leasehold land*

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

|  | Three months ended December 31, |      |
|--|---------------------------------|------|
|  | 2013                            | 2012 |
| Sale of interest in leasehold land:              |                                 |      |
| Proceeds   | \$ 140,000                      | \$ - |
| Fees   | (20,000)                        | -    |
| Revenues sale of interest in leasehold land, net | \$ 120,000                      | \$ - |

WB sold one single-family lot in Phase I of Increment I during the three months ended December 31, 2013. This sale occurred prior to our purchase of an ownership interest in the land development partnerships.

As of December 31, 2013, 32 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 released and began marketing a portion of the 42 single-family lots in Phase II of Increment I, and as of December 31, 2013, one of the lots has been sold. It is uncertain when or if WB will complete the remaining single-family lots in Phase II of Increment I and there is no assurance with regards to the amounts of future sales from Increment I.

*Contract drilling*

Contract drilling revenues and contract drilling costs increased \$892,000 (124%) and \$704,000 (116%), respectively, for the three months ended December 31, 2013, as compared to the same period in the prior year. The contract drilling segment generated a \$219,000 operating profit before general and administrative expenses in the three months ended December 31, 2013, an increase in operating results of \$225,000 as compared to the \$6,000 operating loss generated during the same period of the prior year. The increase in operating results was primarily due to increased water well drilling activity and higher contract margins on water well drilling in the current year period, partially offset by increased costs to resolve difficulties encountered on certain pump installation and repair contracts.

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 significant

volatility in demand for water well drilling contracts in recent 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. This has generally led to increased competition for available contracts and lower margins on awarded contracts. Although the Company has experienced a recent increase in water well drilling activity, it is unable to predict the near-term and long-term availability of water well drilling and pump installation and repair contracts as a result of this volatility in demand.

*General and administrative expenses*

General and administrative expenses decreased \$286,000 (13%) for the three months ended December 31, 2013, as compared to the same period in the prior year. The decrease was primarily due to the fact that general and administrative expenses in the current year period included a \$177,000 reduction in stock appreciation rights expense resulting from a decline in the market price of the Company's stock, as compared to a \$32,000 reduction in stock appreciation rights expense in the prior period, and a \$92,000 increase in administrative expense reimbursements from oil and natural gas joint venture partners.

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*Depletion, depreciation, and amortization*

Depletion, depreciation, and amortization decreased \$515,000 (19%) for the three months ended December 31, 2013, as compared to the same period in the prior year. The decrease was primarily due to a 14% decrease in net production and a 6% decrease in the average exchange rate of the Canadian dollar to the U.S. dollar.

*Reduction of carrying value of assets*

Under the full cost method of accounting, the Company performs quarterly oil and natural gas ceiling test calculations. Barnwell's net capitalized costs exceeded the ceiling limitation at December 31, 2012. As such, Barnwell reduced the carrying value of its oil and natural gas properties by \$2,327,000 during the three months ended December 31, 2012. No such reduction was necessary during the three months ended December 31, 2013.

Changes in the 12-month rolling average first-day-of-the-month prices for oil, natural gas and natural gas liquids, the value of reserve additions as compared to the amount of capital expenditures to obtain them, and changes in production rates and estimated levels of reserves, future development costs and the market value of unproved properties, impact the determination of the maximum carrying value of oil and natural gas properties. The Company may be required to record reductions in the carrying value of its oil and natural gas properties in the future, however, the Company is unable to estimate a range of the amount of any potential future reduction in carrying value as variables that impact the ceiling limitation are dependent upon future prices and actual results of activity.

*Equity in loss of affiliates*

On November 27, 2013, Barnwell, through a wholly-owned subsidiary, entered into two limited liability limited partnerships, KD Kona 2013 LLLP and KKM Makai, LLLP, and indirectly acquired 19.6% interest in each WB Kukio Resorts, LLC, WB Maniniowali, LLC, and WB Kaupulehu, LLC for \$5,140,000. Barnwell's investment in these entities is accounted for using the equity method of accounting. For the period from the acquisition date, November 27, 2013, to December 31, 2013, Barnwell was allocated partnership losses of \$147,000.

*Income taxes*

Barnwell's effective consolidated income tax benefit rate for the three months ended December 31, 2013 and 2012, after adjusting loss before income taxes for non-controlling interests, was 6% and 17%, respectively.

Consolidated taxes do not bear a customary relationship to pretax losses due primarily 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 any future U.S. tax benefit prior to expiration.

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

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*Net loss 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 for the three months ended December 31, 2013 totaled \$11,000, as compared to net loss attributable to non-controlling interests of \$40,000 for the same period in the prior year. The \$29,000 (73%) change is due primarily to impacts to non-controlling interests of higher revenues reported by the land investment segment in the current period as compared to the same period in the prior year.

**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 December 31, 2013, Barnwell had \$5,269,000 in cash and cash equivalents and \$6,804,000 of available credit under its credit facility with its Canadian bank.

*Cash Flows*

Cash flows provided by operations totaled \$999,000 for the three months ended December 31, 2013, as compared to \$1,743,000 for the same period in the prior year. This \$744,000 decrease was primarily due to changes in working capital.

Net cash used in investing activities totaled \$5,632,000 during the three months ended December 31, 2013, as compared to \$967,000 during the same period of the prior year. The increase was primarily due to a \$4,140,000 payment to acquire interest in the land development partnerships and a \$644,000 increase in cash outflows for oil and natural gas capital expenditures.

Cash flows provided by financing activities totaled \$2,116,000 for the three months ended December 31, 2013, as compared to \$428,000 during the same period of the prior year. The \$1,688,000 increase in cash flows was primarily due to a \$3,684,000 increase in proceeds from debt borrowings as compared to the prior year period due to the land investment loan which was obtained on November 27, 2013, partially offset by a \$2,000,000 increase in restricted



cash, which includes an interest reserve account and a pledged deposit account related to the loan.

In January 2014, Barnwell paid an additional \$1,000,000 to fund the remainder of the acquisition price of the interests in the land development partnerships, of which approximately \$814,000 was borrowed under the land investment loan bringing the total borrowings to the facility maximum of \$5,000,000. At December 31, 2013, the \$1,000,000 is accrued under the caption Payable to affiliate in the Condensed Consolidated Balance Sheets.

#### *Credit Arrangements*

Barnwell has a credit facility at Royal Bank of Canada, a Canadian bank, for \$20,000,000 Canadian dollars, or US\$18,804,000 at the December 31, 2013 exchange rate of 0.9402. Borrowings under this facility were US\$12,000,000 and unused credit available under this facility was US\$6,804,000 at December 31, 2013. The interest rate on the facility at December 31, 2013 was 2.66%. Under the financing agreement with Royal Bank of Canada, the facility is reviewed annually, with the next review planned for April 2014. Subject to that review, the facility may be renewed for one year with no debt repayments or converted to a two-year term loan by the bank.

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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 change in the interest rate, the sale of the 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 December 31, 2013 was 3.53%. 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 the 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.

On November 27, 2013, Barnwell, through affiliated entities, entered into a non-revolving loan with a Hawaii bank for \$5,000,000 and borrowed approximately \$4,186,000 on the loan to partially fund the acquisition of interests in the land development partnerships and certain acquisition costs. In January 2014, an additional \$814,000 was borrowed on the loan to partially fund the remainder of the acquisition price, bringing the total borrowings under the land investment loan to the facility maximum of \$5,000,000. The bank loan matures in December 2015, with an option to extend one year, and accrues interest for the first year at 4.5% and resets annually thereafter to the lender's then prevailing interest rate for similarly priced commercial mortgage loans or to the lender's base rate plus 0.50%. The loan is collateralized by Kaupulehu Developments' rights to percentage of sales payments from the sale of lots within Kaupulehu Lot 4A Increments I and II, a second mortgage on Kaupulehu 2007's lots together with all improvements thereon, the interest in the land development partnerships and any distributions from the partnerships, a \$1,000,000 interest reserve account and a \$1,000,000 pledged deposit account. Barnwell is a guarantor of the loan. Principal payments are due on the receipt of percentage of sales payments from the sale of lots within Kaupulehu Lot 4A Increments I and II, upon the sale of Kaupulehu 2007's real estate held for sale and residential parcels and on receipt of cash distributions from the land development partnerships.

The loan agreements contain 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 2.65 to 1.

*Oil and Natural Gas and Other Capital Expenditures*

Barnwell's oil and natural gas capital expenditures, including accrued capital expenditures, totaled \$1,756,000 for the three months ended December 31, 2013, as compared to \$1,865,000 for the same period in the prior year. Management expects that oil and natural gas capital expenditures in fiscal 2014 will range from \$4,000,000 to \$4,500,000. 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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During the three months ended December 31, 2013, Barnwell drilled two gross (1.2 net) development wells in Canada, both of which appear to be successful. The term gross refers to the total number of wells in which Barnwell owns an interest, and net refers to Barnwell's aggregate interest therein. For example, a 50% interest in a well represents one gross well, but 0.5 net well. The gross figure includes interests owned of record by Barnwell and, in addition, the portion owned by others.

*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, 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 2014 review, and/or we fall short of our key financial debt covenants for our real estate and land investment loans and are required to repay all or 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 4. 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 December 31, 2013, 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 December 31, 2013 to ensure that information required to be disclosed by Barnwell in the 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.

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*Changes in Internal Control Over Financial Reporting*

There was no change in Barnwell's internal control over financial reporting during the quarter ended December 31, 2013 that materially affected, or is reasonably likely to materially affect, Barnwell's internal control over financial reporting.

PART II - OTHER INFORMATION

**ITEM 1A. RISK FACTORS**

Other than as set forth below, there have been no material changes from the risk factors set forth in our Annual Report on Form 10-K for the year ended September 30, 2013.

**We hold investment interests in unconsolidated land development partnerships, which are accounted for using the equity method of accounting, in which we do not have a controlling interest. These investments involve risks and are highly illiquid.**

These investments involve risks which include:

- the lack of a controlling interest in these partnerships and, therefore, the inability to require that the entities sell assets, return invested capital or take any other action without obtaining the majority vote of partners;
- potential for future additional capital contributions to fund operations and development activities;
- the adverse impact on overall profitability if the entities do not achieve the financial results projected;
- the reallocation of amounts of capital from other operating initiatives and/or an increase in our indebtedness to pay potential future additional capital contributions, which could in turn restrict our ability to access additional capital when needed or to pursue other important elements of our business strategy;

- undisclosed, contingent or other liabilities or problems, unanticipated costs, and an inability to recover or manage such liabilities and costs; and
- certain underlying partnership data is not accessible to us, therefore we depend on the general partner to provide us with reliable accounting information.

**We may be required to write-down the carrying value of our investment in land development partnerships if our assumptions about future lot sales and profitability prove incorrect.**

In analyzing the value of our investment in land development partnerships, we have made assumptions about the level of future lot sales, operating and development costs, cash generation, and market conditions. These assumptions are based on management's and the general partner's best estimates and if the actual results differ significantly from these assumptions, we may not be able to realize the value of the assets recorded, which could lead to an impairment of certain of these assets in the future.

Table of Contents**We face risks related to balloon payments and refinancings.**

Certain of our loans will have significant outstanding principal balances on their maturity dates, commonly known as balloon payments. There can be no assurance that we will have the funds available to fund the balloon payments or that we will be able to refinance the loans on favorable terms or at all. To the extent we cannot either pay off or refinance the loans on favorable terms or at all, we may be forced to dispose of properties or other assets on disadvantageous terms or pay higher interest rates, either of which could have an adverse impact on our financial condition and results of operations.

**ITEM 6. EXHIBITS**

| Exhibit<br>Number | Description  |
|-------------------|--|
| 10.7              | Limited Liability Limited Partnership Agreement of KD Kona 2013 LLLP dated November 27, 2013   |
| 10.8              | Limited Liability Limited Partnership Agreement of KKM Makai, LLLP dated November 27, 2013   |
| 10.9              | Loan Agreement, dated as of November 27, 2013 between KD Kona 2013 LLLP and KKM Makai, LLLP, as the borrowers, and American Savings Bank, F.S.B. as the lender |
| 31.1              | Certification of Chief Financial Officer Pursuant To Section 302 of the Sarbanes-Oxley Act of 2002   |
| 31.2              | Certification of Chief Executive 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  |
| 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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**SIGNATURE**

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

**BARNWELL INDUSTRIES, INC.**  
(Registrant)

Date: February 14, 2014

/s/ Russell M. Gifford  
Russell M. Gifford  
Chief Financial Officer,  
Executive Vice President,  
Treasurer and Secretary

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