

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

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 2012

or

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

Commission File Number 1-5103

BARNWELL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

72-0496921
(I.R.S. Employer Identification No.)

1100 Alakea Street, Suite 2900, Honolulu, Hawaii
(Address of principal executive offices)

96813-2833
(Zip code)

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

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

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

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

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

Yes No

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

Yes No

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

Yes No

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

Yes No

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

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 Act). Yes No

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

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

Documents Incorporated by Reference

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

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

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

deduction of the royalty share due others.

NGL(s)

natural gas liquid(s)

SEC

United States Securities and Exchange Commission

Water Resources

Water Resources International, Inc.

WB

WB KD Acquisition, LLC

WBKD

WB KD Acquisition II, LLC

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PART I

CAUTIONARY STATEMENT RELEVANT TO FORWARD-LOOKING INFORMATION

FOR THE PURPOSE OF SAFE HARBOR PROVISIONS OF THE

PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

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

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

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

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

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ITEM 1. BUSINESS

Overview

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

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

Oil and Natural Gas Segment

Overview

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

Operations

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

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

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

Key Property

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

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

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

Preparation of Reserves Estimates

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

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

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

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

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

Reserves

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

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

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

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

Standardized Measure of Discounted Future Net Cash Flows

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

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

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

Oil and Natural Gas Production

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

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	2012	Year ended September 30, 2011	2010
Annual net production:			
Natural gas liquids (Bbls)	91,000	93,000	103,000
Oil (Bbls)	168,000	157,000	