



Barnwell Industries, Inc.

2005 Annual Report

Barnwell Industries, Inc. and its subsidiaries are principally engaged in the business of exploring for, developing, producing, and selling natural gas and oil in Canada, investing in leasehold land in Hawaii, and drilling wells and maintaining water systems in Hawaii.

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BARNWELL INDUSTRIES, INC.

TO OUR STOCKHOLDERS:

Fiscal 2005 was a sterling year for your Company; the highest in revenues and third highest in net earnings. Net earnings were \$6,027,000 (\$0.70 per share – diluted) in 2005, oil and natural gas capital expenditures reached a record high for the Company, \$18,229,000, and the Company ended the year with cash and cash equivalents of \$5,492,000. Additionally, the Company had its first ever stock split, splitting two-for-one in January 2005 and then a second stock split, splitting three-for-one, in November 2005. The market price of the Company's common stock increased from \$7.75 (split-adjusted) at September 30, 2004 to \$21.32 (split-adjusted) at September 30, 2005, a 175% increase.

Net earnings in fiscal 2005 were less than in fiscal 2004 as fiscal 2004 net earnings included the receipt of an \$11,550,000 closing payment from the sale by Kaupulehu Developments, a general partnership in which the Company has a 77.6% controlling interest, to WB KD Acquisition LLC ("WB") of an interest in leasehold land in Hawaii in February 2004, and deferred income tax benefits of \$1,740,000 due to the enactment of reductions in Canadian income tax rates. In addition, net earnings were less than in fiscal 2004 because of an increase in stock appreciation rights expense, after income taxes, of \$1,608,000 in fiscal 2005 as compared to fiscal 2004 resulting from an increase in the market price of the Company's stock.

Our successful oil and natural gas operations were the main contributor to net earnings in fiscal 2005. Oil and natural gas revenues increased \$8,884,000 or 37% over fiscal 2004 primarily as a result of higher natural gas and oil prices. The oil and natural gas prices received by the Company increased 45% and 29%, respectively, as compared to fiscal 2004, and natural gas production increased 7% as compared to fiscal 2004; oil and natural gas liquids production decreased 2% as compared to fiscal 2004. We believe that the Company's oil and natural gas exploration and development programs, which have grown substantially and have totaled over \$41,000,000 these past three years, will bring about a further increase in the Company's oil and natural gas revenues in fiscal 2006 as compared to fiscal 2005.

The Company's proved oil and natural gas properties as of September 30, 2005, as determined by independent petroleum engineers, are projected to generate undiscounted future after-tax net cash flows of approximately \$171,000,000. The projection was based on prices as of September 30, 2005 and assumes no price increases. Additionally, the Company holds land leases for over 100,000 net acres of undeveloped oil and natural gas properties in Canada.

The February 2004 sale of leasehold interests by Kaupulehu Developments to WB referred to in the second paragraph encompassed two increments comprising approximately 870 leasehold acres of land zoned resort/residential, which are located adjacent to and north of the five diamond Four Seasons Resort Hualalai at Historic Ka'upulehu on the Kona coast of the island of Hawaii. The first increment consists of 80 single-family lots. The second increment is the remaining portion of the approximately 870-acre property which is zoned for single-family and multi-family residential units and a golf course and clubhouse.



In 2005, WB received federal and State of Hawaii approvals to begin marketing the first phase of 38 lots of the first increment of 80 single-family lots on property bordering the Pacific Ocean. WB has excavated, processed and placed material on the single-family lots bringing a majority of the first phase of 38 lots to finished grade. WB is obligated to make percentage payments to Kaupulehu Developments, the ultimate amount of which is not currently known, based on the gross amounts received on the sale of the 80 single-family lots. For the second increment, Kaupulehu Developments and WB have agreed to use diligent efforts to negotiate an agreement regarding the ownership and development of the second increment within three (3) years following the closing of the sale of the first single-family lot in the first increment.

Kaupulehu Developments also has a leasehold interest in approximately 1,000 acres of conservation-zoned land on the ocean side of the Queen Kaahumanu Highway adjacent to these 870 acres of urban-zoned land. Additionally, Kaupulehu Developments has interests in development rights within Hualalai Resort for which it received \$2,656,000 in fiscal 2005, the fourth of ten scheduled option payments relating to the development rights. We are very pleased to report that in November 2005 Kaupulehu Developments received the fifth scheduled payment of \$2,656,000 and a \$219,000 portion of the sixth payment. There are five remaining option payments, one of \$2,437,000 due on December 31, 2006, and four of \$2,656,000 due on each December 31 of years 2007 to 2010. If any annual option payment is not made, the remaining development right options will expire. There is no assurance that any portion of the remaining options will be exercised.

Our Hawaii contract drilling operations also contributed to the Company's net earnings, generating positive cash flows from operations and an operating profit. Additionally, the drilling company currently has a backlog of approximately \$3,000,000 in contracts for drilling and pump installation work.

We are pleased to report that we have nominated Mr. Ahron H. Haspel to be a Director of the Company. Mr. Haspel, who is both a lawyer and a CPA, is currently a partner with the international law firm of Jones Day, and was a partner with KPMG LLP for over 25 years.

We thank you, our stockholders, for your continued support.

For the Board of Directors,

Morton H. Kinzler
Chairman of the Board and
Chief Executive Officer

Alexander C. Kinzler
President, Chief Operating Officer
General Counsel and Director

FINANCIAL AND OPERATING HIGHLIGHTS
Years ended September 30,

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
<u>FINANCIAL:</u>					
Revenues	<u>\$ 44,210,000</u>	<u>\$ 38,540,000</u>	<u>\$ 24,160,000</u>	<u>\$ 16,360,000</u>	<u>\$ 24,430,000</u>
Net earnings	<u>\$ 6,027,000</u>	<u>\$ 8,710,000</u>	<u>\$ 2,320,000</u>	<u>\$ 40,000</u>	<u>\$ 3,830,000</u>
Net earnings per share – diluted	<u>\$ 0.70</u>	<u>\$ 1.03</u>	<u>\$ 0.28</u>	<u>\$ 0.01</u>	<u>\$ 0.47</u>
<u>OPERATING:</u>					
Production - Oil and natural gas liquids (barrels)	<u>253,000</u>	<u>259,000</u>	<u>227,000</u>	<u>242,000</u>	<u>272,000</u>
Natural gas (MCF)	<u>3,621,000</u>	<u>3,383,000</u>	<u>3,175,000</u>	<u>3,277,000</u>	<u>3,269,000</u>
Average price - Oil and natural gas liquids, per barrel	<u>\$ 40.78</u>	<u>\$ 29.57</u>	<u>\$ 25.37</u>	<u>\$ 17.85</u>	<u>\$ 24.42</u>
Natural gas, per MCF	<u>\$ 5.93</u>	<u>\$ 4.60</u>	<u>\$ 4.27</u>	<u>\$ 2.12</u>	<u>\$ 4.02</u>
<u>RESERVES:</u>					
At September 30,					
Proved reserves:					
Oil and liquids-barrels	<u>1,306,000</u>	<u>1,304,000</u>	<u>1,401,000</u>	<u>1,527,000</u>	<u>1,536,000</u>
Natural gas – MCF*	<u>25,234,000</u>	<u>26,825,000</u>	<u>27,639,000</u>	<u>27,166,000</u>	<u>28,371,000</u>
Total natural gas and natural gas equivalent of oil and liquids**– MCF	<u>33,070,000</u>	<u>34,649,000</u>	<u>36,045,000</u>	<u>36,328,000</u>	<u>37,587,000</u>

* MCF means 1,000 cubic feet

** Oil and liquids are converted to natural gas equivalents on the basis of one barrel equals 5.8 MCF.

OIL AND NATURAL GAS RESERVES AT SEPTEMBER 30, 2005

The following table sets forth Barnwell's oil and natural gas reserves at September 30, 2005, by property name, based on information prepared by Paddock Lindstrom & Associates Ltd. Gross reserves are before the deduction of royalties; net reserves are after the deduction of royalties net of the Alberta Royalty Tax Credit. This table is based on constant dollars where reserve estimates are based on sales prices, costs and statutory tax rates in existence at the date of the projection. Oil, which includes natural gas liquids ("NGL"), is shown in thousands of barrels ("MBBL") and natural gas is shown in millions of cubic feet ("MMCF").

Property Name	Total Proved Producing				Total Proved			
	Oil & NGL		Gas		Oil & NGL		Gas	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net
	(MBBL)	(MBBL)	(MMCF)	(MMCF)	(MBBL)	(MBBL)	(MMCF)	(MMCF)
Dunvegan	656	456	16,394	12,947	704	489	17,616	13,858
Red Earth	332	290	-	-	351	304	-	-
Bonanza/Balsam	104	87	1,036	856	105	87	1,227	1,000
Pouce Coupe South	11	7	1,359	1,105	11	7	1,359	1,105
Medicine River	38	28	902	606	38	28	902	606
Doris	3	3	1,196	936	3	3	1,770	1,379
Leduc	8	6	721	591	8	6	778	640
Faith South	-	-	-	-	-	-	1,011	790
Hillsdown	13	10	581	465	29	23	746	597
Chauvin	96	85	13	11	96	85	13	11
Wood River	4	4	533	445	43	36	786	652
Progress	22	21	575	473	114	102	766	612
Thornbury	-	-	745	651	-	-	779	680
Charlotte Lake	-	-	292	268	-	-	512	452
Pouce Coupe	4	4	430	361	4	4	430	361
Rat Creek	30	24	232	199	30	24	232	199
Hilda	-	-	231	222	-	-	231	222
Zama	-	-	52	36	-	-	296	196
Mulligan	1	1	240	195	1	1	240	195
Wizard Lake	26	22	-	-	26	22	-	-
Armada	-	-	141	135	-	-	141	135
Boundary Lake	-	-	544	396	17	15	544	396
Smaller Alberta properties	41	35	631	602	41	35	696	660
Boundary Lake, British Columbia	20	18	219	201	38	34	385	347
Hatton, Saskatchewan	-	-	196	141	-	-	196	141
Webb-Beverley, Saskatchewan	1	1	-	-	1	1	-	-
TOTAL	1,410	1,102	27,263	21,842	1,660	1,306	31,656	25,234

Properties are located in Alberta, Canada unless otherwise noted.



December 9, 2005

REPORT OF MANAGEMENT

The management of Barnwell Industries, Inc. prepared, and is responsible for, the accompanying consolidated financial statements and for their integrity and objectivity. The consolidated financial statements present fairly the Company's financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. In preparing its consolidated financial statements, the Company includes amounts that are based on estimates and judgments that management believes are reasonable under the circumstances.

Barnwell Industries, Inc. maintains systems of accounting and internal controls to provide reasonable assurances that the Company's assets are protected from unauthorized use and that all transactions are executed in accordance with established authorizations and recorded properly. Management believes that these systems provide reasonable assurance that the books and records accurately reflect the transactions of the Company.

The accompanying consolidated financial statements have been audited by KPMG LLP, the independent registered public accounting firm appointed by the Board of Directors. Management has made available to KPMG LLP all of the Company's financial records and related data, as well as the minutes of stockholders', directors' and board of directors' committee meetings.

The audit committee, composed of independent directors, meets periodically with KPMG LLP and financial management. The participants in these meetings discuss the Company's internal accounting controls, KPMG LLP's findings and opinion, financial information, and related matters. KPMG LLP has unrestricted access to the audit committee, to discuss any matter that they wish to call to the Committee's attention.

Morton H. Kinzler
Chief Executive Officer and
Chairman of the Board

Alexander C. Kinzler
President,
Chief Operating Officer, and
General Counsel

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion is intended to assist in the understanding of the consolidated balance sheets of Barnwell Industries, Inc. and subsidiaries (collectively referred to herein as "Barnwell") as of September 30, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended September 30, 2005. This discussion should be read in conjunction with the Consolidated Financial Statements and related Notes to Consolidated Financial Statements included in this report.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results could differ significantly from those estimates.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In response to U.S. Securities and Exchange Commission Release No. 33-8040, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies," Barnwell has identified certain of its policies as being of particular importance to the understanding of its financial position and results of operations and which require the application of significant judgment by management.

Oil and natural gas properties

Barnwell uses the full cost method of accounting under which all costs incurred in the acquisition, exploration and development of oil and natural gas reserves, including costs related to unsuccessful wells and estimated future site restoration and abandonment, are capitalized until such time as the aggregate of such costs net of accumulated depletion and oil and gas related deferred income taxes, on a country-by-country basis, equals the sum of 1) the discounted present value (at 10%), using prices as of the end of the fiscal year on a constant basis, of Barnwell's estimated future net cash flows from estimated production of proved oil and natural gas reserves as determined by independent petroleum engineers, less estimated future expenditures to be incurred in developing and producing the proved reserves but excluding future cash outflows associated with settling asset retirement obligations accrued on the balance sheet; plus 2) the cost of major development projects and unproven properties not subject to depletion, if any; plus 3) the lower of cost or estimated fair value of unproven properties included in costs subject to depletion; less 4) related income tax effects. If net capitalized costs exceed this limit, the excess is expensed. Depletion is computed using the units-of-production method whereby capitalized costs, net of salvage values, plus estimated future costs to develop proved reserves and satisfy asset retirement obligations, are amortized over the total estimated proved reserves on a country-by-country basis. Investments in major development projects are not depleted until either proved reserves are associated with the projects or impairment has been determined. At September 30, 2005 and 2004, Barnwell had no investments in major oil and natural gas development projects that were not being depleted. General and administrative costs related to oil and natural gas operations are expensed as incurred. Proceeds from the disposition of minor producing oil and natural gas properties are credited

to the cost of oil and natural gas properties. Gains or losses are recognized on the disposition of significant oil and natural gas properties.

Investment in land and revenue recognition

Barnwell's investment in land is comprised of development rights under option; rights to receive percentage payments; leasehold land interests in land zoned resort/residential which are under right of negotiation; and land zoned conservation which is not under option or right of negotiation. Investment in land is reported at the lower of the asset carrying value or fair value, less costs to sell, and is evaluated for impairment whenever events or changes in circumstances indicate that the recorded investment balance may not be fully recoverable.

Costs incurred for the acquisition and improvement of leasehold land interests, including capitalized interest, are included in the consolidated balance sheets under the caption "Investment in Land."

Sales of development rights under option and revenues from the sale of Increment I of leasehold land interests are accounted for under the cost recovery method. Under the cost recovery method, no operating profit is recognized until cash received exceeds the cost and the estimated future costs related to the development rights sold.

Contract drilling

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

Income taxes

Deferred income taxes are determined using the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax impacts of differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax asset will not be realized. Barnwell has established a valuation allowance primarily for the U.S. tax effect of deferred Canadian taxes, foreign tax credits, accrued expenses and state of Hawaii net operating loss carryforwards which may not be realizable in future years as there can be no assurance of any specific level of earnings or that the timing of U.S. earnings will coincide with the payment of Canadian taxes to enable Canadian taxes to be fully deducted (or recoverable) for U.S. tax purposes.

Net deferred tax assets at September 30, 2005 of \$4,800,000 consists of \$3,322,000 related to expenses accrued for book purposes but not for tax purposes and \$972,000 related to the excess of the cost basis of investment in land for tax purposes over the cost basis of investment in land for book purposes. Canadian deferred tax assets related to expenses accrued for book purposes but not for tax purposes are estimated to be realized through future Canadian income tax deductions against future Canadian oil and natural gas earnings. U.S. deferred tax assets related to expenses accrued for book purposes but not for tax purposes and the excess of the cost basis of investment in land for tax purposes over the cost basis of investment in land for book purposes are estimated to be realized from deductions against future U.S. earnings from sales of interests in leasehold land and land development rights. Additionally, at September 30, 2005, Barnwell had a deferred tax asset of \$461,000 for alternative minimum tax credit carryforwards which are available to reduce future U.S. federal regular income taxes over an indefinite period, and a net deferred tax asset of \$45,000 for a state net operating loss carryforward which is available to reduce future state income taxes arising from future sales of interests in leasehold land and land development rights and expires if not utilized on or before September 30, 2025. The amount of deferred income tax assets considered realizable may be reduced if estimates of future taxable income are reduced.

Pension Plan

Barnwell sponsors a noncontributory defined benefit pension plan covering substantially all of its U.S. employees, with benefits based on years of service and the employee's highest consecutive five-year average earnings. Barnwell accounts for its defined benefit pension plan in accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," which requires that amounts recognized in financial statements be determined on an actuarial basis. Statement of Financial Accounting Standards No. 87 requires that the effects of the performance of the pension plan's assets and changes in pension liability discount rates on Barnwell's computation of pension income (expense) be amortized over future periods. Any variances in the future between the assumed rates utilized for actuarial purposes and the actual rates experienced by the plan may materially affect Barnwell's results of operations or financial condition.

During and as of the end of fiscal 2005 and fiscal 2004, Barnwell assumed an expected long-term rate of return on plan assets of 8% and an expected rate of future annual compensation increases of 5%.

At the end of each year, Barnwell determines the discount rate to be used to calculate the present value of plan liabilities. The discount rate is an estimate of the current interest rate at which the pension liabilities could be effectively settled at the end of the year. In estimating this rate, Barnwell looks to rates of return on high-quality, fixed-income investments. At September 30, 2005, Barnwell determined this rate to be 5.25% as compared to a discount rate of 5.75% used at September 30, 2004.

At September 30, 2005, Barnwell's accrued benefit cost was \$517,000. For the year ended September 30, 2005, Barnwell recognized a net periodic benefit cost of \$249,000 and recorded an additional minimum liability of \$132,000.

Asset Retirement Obligation

On October 1, 2002, Barnwell adopted Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations," which requires that the fair value of a liability

for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The asset retirement obligation reflects Barnwell's obligation to plug and abandon natural gas and oil wells, dismantle and remove related equipment and plants, and restore the properties to a suitable condition at the end of oil and gas operations based on Barnwell's net ownership interest in the properties. The asset retirement obligation is recorded at fair value in the period in which it is incurred along with a corresponding increase in the carrying amount of the related asset. Barnwell has estimated fair value by discounting the estimated future cash outflows required to settle abandonment and restoration liabilities. The present value calculation includes numerous estimates, assumptions and judgments regarding the existence of liabilities, the amount and timing of cash outflows required to settle the liability, what constitutes adequate restoration, inflation factors, credit adjusted discount rates, and consideration of changes in legal, regulatory, environmental and political environments. Asset retirement costs included in the carrying amount of the related asset are depleted over the estimated life of the associated reserves, and the discounted present value of the asset retirement obligation is accreted and included in oil and natural gas operating expenses. Abandonment and restoration cost estimates are determined in conjunction with Barnwell's reserve engineers based on historical information regarding costs incurred to abandon and restore similar well sites, information regarding current market conditions and costs, and knowledge of subject well sites and properties.

CONTRACTUAL OBLIGATIONS

The following table lists the scheduled maturities of long-term debt, estimating that Barnwell's credit facility with the Royal Bank of Canada will be renewed on each annual renewal date, currently April 30, and scheduled minimum rental payments of non-cancelable operating leases for office space and leasehold land:

<u>Contractual Obligations</u>	<u>Payments Due by Fiscal Year</u>				<u>Total</u>
	<u>2006</u>	<u>2007-2008</u>	<u>2009-2010</u>	<u>After 2010</u>	
Long-term debt	\$ -	\$ -	\$ -	\$11,576,000	\$11,576,000
Operating leases	<u>518,000</u>	<u>940,000</u>	<u>862,000</u>	<u>2,167,000</u>	<u>4,487,000</u>
Total	<u>\$518,000</u>	<u>\$940,000</u>	<u>\$862,000</u>	<u>\$13,743,000</u>	<u>\$16,063,000</u>

There is no assurance that the bank will in fact extend the term of the facility on each renewal date or that the facility will be renewed at its current amount. The following table lists the scheduled maturities of long-term debt assuming that the facility will not be renewed on the next renewal date and that Barnwell then elects to convert the revolving facility to term status, and scheduled minimum rental payments of non-cancelable operating leases for office space and leasehold land:

<u>Contractual Obligations</u>	<u>Payments Due by Fiscal Year</u>				<u>Total</u>
	<u>2006</u>	<u>2007-2008</u>	<u>2009-2010</u>	<u>After 2010</u>	
Long-term debt	\$ -	\$11,576,000	\$ -	\$ -	\$11,576,000
Operating leases	<u>518,000</u>	<u>940,000</u>	<u>862,000</u>	<u>2,167,000</u>	<u>4,487,000</u>
Total	<u>\$518,000</u>	<u>\$12,516,000</u>	<u>\$862,000</u>	<u>\$2,167,000</u>	<u>\$16,063,000</u>

The lease payments for land are subject to renegotiation after December 31, 2005. Per the lease agreement, the lease payments will remain unchanged pending an appraisal, after which the lease rent

will be adjusted to fair market value. Barnwell currently does not know the amount of the new lease payments which could be effective January 1, 2006; they may remain unchanged or increase. The future rental payment disclosures above assume the minimum lease payments for land in effect at December 31, 2005 remain unchanged through December 2025, the end of the lease term.

OVERVIEW

Barnwell is engaged in the following lines of business: 1) oil and natural gas exploration, development, production and sales essentially all in Canada (oil and natural gas segment), 2) investment in leasehold land in Hawaii (land investment segment), and 3) drilling wells and installing and repairing water pumping systems in Hawaii (contract drilling segment).

Barnwell sells substantially all of its oil and condensate production under short-term contracts with marketers of oil. Natural gas sold by Barnwell is generally sold under both long-term and short-term contracts with prices indexed to market prices. The price of natural gas, oil and natural gas liquids is freely negotiated between the buyers and sellers. Market prices for petroleum products are dependent upon factors such as, but not limited to, changes in weather, storage levels, and output. Petroleum and natural gas prices are very difficult to predict and fluctuate significantly. For example, natural gas prices for Barnwell, based on quarterly averages during the three years ended September 30, 2005, have ranged from a low of \$3.26 per thousand cubic feet to a high of \$7.25 per thousand cubic feet, and tend to be higher in the winter than in the summer due to increased demand. Oil and natural gas exploration, development and operating costs generally follow trends in product market prices, thus in times of higher product prices the cost of exploration, development and operation of oil and natural gas properties will tend to escalate as well. Barnwell's oil and natural gas operations make capital expenditures in the exploration, development, and production of oil and natural gas. Cash outlays for capital expenditures are largely discretionary, however, a minimum level of capital expenditures is required to replace depleting reserves. Due to the nature of oil and natural gas exploration and development, significant uncertainty exists as to the ultimate success of any drilling effort.

Barnwell owns a 77.6% controlling interest in Kaupulehu Developments, a Hawaii general partnership which owns interests in leasehold land and development rights for property located approximately six miles north of the Kona International Airport in the North Kona District of the Island of Hawaii, adjacent to and north of the Four Seasons Resort Hualalai at Historic Ka'upulehu, between the Queen Kaahumanu Highway and the Pacific Ocean. Kaupulehu Developments' development rights are under option to a developer and revenues are recognized when options are exercised. In February 2004, Kaupulehu Developments entered into an agreement with an independent buyer whereby Kaupulehu Developments transferred its leasehold interest in approximately 870 acres zoned for resort/residential development, in two increments, to the buyer. For the first increment ("Increment I"), Kaupulehu Developments received an \$11,550,000 cash closing payment in February 2004 and is also entitled to receive future payments from the buyer based on the following percentages of gross receipts from the developer's sales of single-family residential lots in Increment I: 9% of the gross proceeds from single-family lot sales up to aggregate gross proceeds of \$100,000,000; 10% of such aggregate gross proceeds greater than \$100,000,000 but less than \$300,000,000; and 14% of such aggregate gross proceeds in excess of \$300,000,000. For the second increment ("Increment II"), Kaupulehu Developments agreed to use diligent efforts to negotiate, and attempt to document and enter into, prior to the date which is three (3) years following the closing of the sale of the first single-family lot in Increment I, an agreement with regards to the ownership and development of Increment II. The area in

which Kaupulehu Developments' interests are located has experienced strong demand for premium residential real estate in recent years, however there is no assurance that any future development rights or percentage payments will be received.

Barnwell also drills 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. Water well drilling and pump installation operating profits during fiscal 2005 reflected the impact of increased activity in the number and value of contracts awarded by the various governmental and private entities. Contract drilling operating profits have, however, started to decrease in recent months, and management expects a lower level of activity and operating profit in fiscal 2006, as compared to fiscal 2005.

RESULTS OF OPERATIONS

Summary

Barnwell generated net earnings of \$6,027,000 in fiscal 2005, a \$2,683,000 decrease from net earnings of \$8,710,000 in fiscal 2004. The decrease was the result of fiscal 2004 net earnings including the receipt of a closing payment from the sale of an interest in leasehold land in February 2004 which generated an operating profit, after minority interest and before taxes, of approximately \$5,200,000, and deferred income tax benefits of \$1,740,000 resulting from the enactment of reductions in Canadian federal and Alberta income tax rates; there were no such items in fiscal 2005. Additionally, earnings decreased due to an increase in stock appreciation rights expense, after income taxes, of \$1,608,000 in fiscal 2005 resulting from an increase in the market price of Barnwell's stock and the issuance of additional stock options that have stock appreciation rights. These decreases in net earnings were partially offset by increases in operating profits generated by Barnwell's oil and natural gas and contract drilling segments.

The fiscal year average exchange rate of the Canadian dollar to the U.S. dollar increased 8% in fiscal 2005, as compared to fiscal 2004, and the exchange rate of the Canadian dollar to the U.S. dollar increased 9% at September 30, 2005, as compared to September 30, 2004. This increase in the value of the Canadian dollar in U.S. dollars increased Barnwell's reported assets and liabilities and revenues and expenses.

Barnwell generated net earnings of \$8,710,000 in fiscal 2004, a \$6,390,000 increase from net earnings of \$2,320,000 in fiscal 2003. The increase was the result of an increase in land investment operating profit due to the sale of an interest in leasehold land referred to above, higher operating profit from the sale of development rights, and deferred income tax benefits of \$1,740,000 resulting from a reduction in Canadian income tax rates.

Oil and Natural Gas Revenues

Selected Operating Statistics

The following tables set forth Barnwell's annual net production and annual average price per unit of production for fiscal 2005 as compared to fiscal 2004, and fiscal 2004 as compared to fiscal 2003. Production amounts reported are net of royalties and the Alberta Royalty Tax Credit.

Fiscal 2005 - Fiscal 2004

	Annual Net Production			
	2005	2004	Increase (Decrease)	
			Units	%
Natural gas (MCF)*	3,621,000	3,383,000	238,000	7%
Oil (Bbl)**	139,000	154,000	(15,000)	(10%)
Liquids (Bbl)**	114,000	105,000	9,000	9%

	Annual Average Price Per Unit			
	2005	2004	Increase	
			\$	%
Natural gas (MCF)*	\$ 5.93	\$ 4.60	\$ 1.33	29%
Oil (Bbl)**	\$48.11	\$33.24	\$14.87	45%
Liquids (Bbl)**	\$31.84	\$24.18	\$ 7.66	32%

Fiscal 2004 - Fiscal 2003

	Annual Net Production			
	2004	2003	Increase	
			Units	%
Natural gas (MCF)*	3,383,000	3,175,000	208,000	7%
Oil (Bbl)**	154,000	142,000	12,000	8%
Liquids (Bbl)**	105,000	85,000	20,000	24%

	Annual Average Price Per Unit			
	2004	2003	Increase	
			\$	%
Natural gas (MCF)*	\$ 4.60	\$ 4.27	\$ 0.33	8%
Oil (Bbl)**	\$33.24	\$27.69	\$ 5.55	20%
Liquids (Bbl)**	\$24.18	\$21.50	\$ 2.68	12%

*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 increased \$8,884,000 (37%) from \$23,840,000 in fiscal 2004 to \$32,724,000 in fiscal 2005, due to increases in prices for all petroleum products and increases in natural gas production, partially offset by a decrease in net oil production. Natural gas production increased essentially due to an increase in production at Dunvegan, Barnwell's principal oil and gas property, and where Barnwell has invested a significant amount of capital these past three years, approximately \$9,192,000. Net natural gas production at Dunvegan increased 227,000 MCF or 15% and net natural gas liquids and oil production at Dunvegan increased 10,000 barrels or 12%. Natural gas production also increased at Barnwell's newer properties at Doris, Malmo and Armada, but declined at Balsam, Bonanza, Leduc and Progress, which are also newer properties, and at other older properties which largely offset the net increase in production at the newer properties. Additionally, natural gas and natural

gas liquids production at Dunvegan was reduced by approximately 30,000 MCF and 3,000 barrels, respectively, in fiscal 2005 as compared to fiscal 2004 due to plant maintenance in the current fiscal year. There was no such plant maintenance program in fiscal 2004. Such plant maintenance usually occurs annually and management expects the operator to perform plant maintenance next year.

Oil production declined in fiscal 2005 due to a 12,000 barrel (15%) decline in production at Barnwell's largest oil producing property, Red Earth, principally due to the natural aging of the property. Oil production also declined at other mature properties but these declines were offset by increases in production at Balsam and Bonanza, two of Barnwell's newer properties.

Oil and natural gas revenues increased \$4,010,000 (20%) from \$19,830,000 in fiscal 2003 to \$23,840,000 in fiscal 2004, due to increases in both prices and production volumes for all petroleum products. Natural gas prices increased 8%, and natural gas production increased 7%. The increase in natural gas production was due to both new production from the Bonanza, Doris, South Pouce Coupe and Leduc areas and natural gas production from the Dunvegan property which increased approximately 7% as a result of an infill drilling program in fiscal 2004 and late fiscal 2003 which added 39 gross development wells (3.4 net wells). The increase in natural gas production was partially offset by production declines at the Thornbury, Pouce Coupe, Progress, and Pollockville areas. Oil prices increased 20%, and oil production increased 8% due to new production from the Wizard Lake and Bonanza areas, partially offset by a decrease in production from older oil properties. Natural gas liquids prices increased 12%, and natural gas liquids production increased 24% due to the infill drilling program at the Dunvegan area mentioned above and due to the fact that fiscal 2003 natural gas liquids production was impacted by a fire in early October 2002 at a Dunvegan gas plant which prevented stripping of natural gas liquids from the natural gas; this resulted in an approximately 6,000 barrel lower liquids net production in fiscal 2003, as compared to fiscal 2004.

Oil and Natural Gas Operating Expenses

Operating expenses increased \$926,000 (16%) to \$6,899,000 in fiscal 2005, as compared to \$5,973,000 in fiscal 2004. The increase was primarily due to an 8% increase in the average exchange rate of the Canadian dollar to the U.S. dollar that increased oil and natural gas operating expenses \$546,000 in fiscal 2005 as compared to the prior year. Also contributing to the increase were operating expenses on new wells.

Operating expenses increased \$1,301,000 (28%) to \$5,973,000 in fiscal 2004, as compared to \$4,672,000 in fiscal 2003, due to the addition of new properties, costs incurred to re-enter wells for repair, maintenance and cleaning, and inflationary pressures on oil field service costs. Also contributing to the increase was a 10% increase in the average exchange rate of the Canadian dollar to the U.S. dollar that increased oil and natural gas operating expenses \$505,000 in fiscal 2004, as compared to fiscal 2003.

Sale of Interest in Leasehold Land, Sale of Development Rights, and Minority Interest in Earnings

On February 13, 2004, Kaupulehu Developments, a land development general partnership in which Barnwell owns a 77.6% controlling interest, entered into a Purchase and Sale Agreement with WB KD Acquisition LLC ("WB") by which Kaupulehu Developments transferred its leasehold interest in approximately 870 acres zoned for resort/residential development, in two increments, to WB. There is no affiliation between Kaupulehu Developments and WB. WB is an affiliate of Westbrook

Partners LLC, an affiliate of the developers of the Kuki'o Resort. Increment I is an area planned for approximately 80 single-family lots and a beach club on the portion of the property bordering the Pacific Ocean. The purchasers of the 80 single-family lots will have the right to apply for membership in the Kuki'o Resort Golf and Beach Club, which is located adjacent to and south of the Four Seasons Resort Hualalai at Historic Ka'upulehu. Increment II is the remaining portion of the approximately 870-acre property and is zoned for single-family and multi-family residential units and a golf course and clubhouse.

With respect to Increment I, Kaupulehu Developments received a non-refundable \$11,550,000 payment ("Closing Payment") in February 2004 and is entitled to receive payment of the following percentages of the gross proceeds generated from the sale by WB of single-family lots in Increment I ("Percentage Payments"): 9% of the gross proceeds from single-family lot sales up to aggregate gross proceeds of \$100,000,000; 10% of such aggregate gross proceeds greater than \$100,000,000 but less than \$300,000,000; and 14% of such aggregate gross proceeds in excess of \$300,000,000. If prior to December 31, 2005, Kaupulehu Developments has not received Percentage Payments equal to or greater than \$2,500,000 in the aggregate, WB will pay Kaupulehu Developments the amount by which the aggregate amount of all prior Percentage Payments made by WB to Kaupulehu Developments is less than \$2,500,000. If prior to December 31, 2006, Kaupulehu Developments has not received Percentage Payments (including payments in lieu of Percentage Payments as described in the immediately preceding sentence) equal to or greater than \$5,000,000 in the aggregate, then WB will pay Kaupulehu Developments the amount by which the aggregate amount of all such payments is less than \$5,000,000. Until the formal granting of access and utility easements by third parties to WB have been completed, WB is entitled, but not required, to withhold payment of Percentage Payments and the minimum payments described above to Kaupulehu Developments until WB's aggregate gross proceeds generated by the sale of single-family lots in Increment I exceeds \$75,000,000. As of the date of this filing, Kaupulehu Developments has received no Percentage Payments and it is Barnwell's understanding that the conditions regarding the formal granting of easements are in progress but have not yet been completed. There is no assurance that any of these future payments will be received.

WB also agreed to pay Kaupulehu Developments non-refundable interim payments of \$50,000 per month ("Interim Payments"), until the first to occur of the closing of the sale of the 40th single-family lot sold in Increment I or WB's payment to Kaupulehu Developments of a total of \$900,000 in Interim Payments subsequent to February 2004. Kaupulehu Developments received the \$900,000 of Interim Payments in full as of August 2005.

Kaupulehu Developments, WB and The Trustees of The Estate of Bernice Pauahi Bishop ("KS") also entered into an agreement (the "Step-In Rights Agreement") whereby if WB elects not to proceed with development of Increment I within the time frame set forth in the Step-In Rights Agreement, which may be extended by KS, or defaults under the terms of its lease with KS, Kaupulehu Developments would have the right to succeed to WB's development rights and develop the property without any payment to WB.

In March 2004, WB commenced engineering of infrastructure, preparation of covenants, conditions and restrictions for a community association, and preparation of legal documents to enable real estate sales, and broke ground and graded several miles of access roads. In 2004, WB received final subdivision approval from the County of Hawaii for the first phase of 38 lots. In 2005, WB received federal and State of Hawaii approvals to begin marketing the first phase of 38 lots of Increment I.

Additionally, during 2004 and 2005, WB excavated, processed and placed material on the single-family lots bringing a majority of the first phase of 38 lots to finished grade.

With respect to Increment II, Kaupulehu Developments and WB agreed to use diligent efforts to negotiate, and attempt to document and enter into, prior to the date which is three (3) years following the closing of the sale of the first single-family lot in Increment I, an agreement with regards to the ownership and development of Increment II. WB, however, may terminate such negotiations at any time without any further obligation. Under the terms of the Step-In Rights Agreement, if at the end of three years following the closing of the sale of the first single-family lot in Increment I the parties have not entered into a definitive agreement with respect to Increment II, the leasehold rights with respect to Increment II will revert to Kaupulehu Developments. In 2005, Kaupulehu Developments and WB held several meetings to discuss possible development scenarios for Increment II. No agreement has been reached with WB for the sale and development of Increment II, although discussions between the parties are ongoing. Accordingly, no revenues or cost of sales have been recognized on Increment II.

The sale of Kaupulehu Developments' interest in Increment I in fiscal 2004 was accounted for by use of the cost recovery method, under which no operating profit is recognized until cash received exceeds the cost and the estimated future costs related to the leasehold interest sold. The revenue from the \$11,550,000 Closing Payment plus \$350,000 of post-closing Interim Payments received in March through September 2004, was reduced by \$693,000 of fees related to the sale, approximately \$402,000 in other costs related to the sale, and \$3,475,000 of previously capitalized costs relating to Increment I. The \$7,330,000 of net revenue from the Closing Payment and Interim Payments for the year ended September 30, 2004 is recorded in the Consolidated Statements of Operations as "Sale of interest in leasehold land, net." Operating profit on the Increment I transaction, after minority interest, totaled approximately \$5,470,000 for the year ended September 30, 2004. During the year ended September 30, 2005, Kaupulehu Developments received additional Interim Payments, before minority interest, totaling \$550,000.

The development rights held by Kaupulehu Developments are for residentially-zoned leasehold land within and adjacent to the Hualalai Golf Club and are under option to Kaupulehu Makai Venture, an unrelated entity that is an affiliate of Kajima Corporation of Japan. Net revenues from the sale of development rights were \$2,497,000 for each of the years ended September 30, 2005 and 2004. In December 2004, Kaupulehu Makai Venture exercised the portion of its development rights option that was to expire on December 31, 2004 and paid Kaupulehu Developments \$2,656,000. Revenue from the development rights sales was reduced by \$159,000 of fees related to the sale, resulting in net revenues of \$2,497,000 and a \$1,950,000 operating profit, after minority interest, on the transaction. On December 31, 2003, Kaupulehu Makai Venture exercised the portion of its development rights option expiring on that date and sent Kaupulehu Developments the required \$2,656,000 option payment, which was received by Kaupulehu Developments in January 2004. Revenue from the option exercise was reduced by \$159,000 of fees related to the sale, resulting in net revenues of \$2,497,000 and a \$1,950,000 operating profit, after minority interest, on the transaction. There were no other costs deducted from revenues from the sale of development rights in the years ended September 30, 2005 and 2004 as all capitalized costs associated with the development rights were expensed in previous years under the cost recovery method. In the year ended September 30, 2003, \$2,125,000 of revenues from the sale of development rights was reduced by \$128,000 of fees related to the sale and \$1,277,000 of cost basis related to the development rights, resulting in net revenues of \$720,000 and a \$280,000 operating profit, after minority interest, on the transaction.

The total amount of remaining future development rights option receipts at September 30, 2005, if all options are fully exercised, was \$15,937,500, comprised of six payments of \$2,656,250 due on each December 31 of years 2005 to 2010. In November 2005, Kaupulehu Makai Venture paid Kaupulehu Developments \$2,875,000 upon exercising the portion of its development rights option due on December 31, 2005 of \$2,656,000 and a portion, \$219,000, of its development rights option due on December 31, 2006, bringing the total remaining future development rights option receipts to \$13,063,000. If any annual option payment is not made, the then remaining development right options will expire. There is no assurance that any portion of the remaining options will be exercised.

The aforementioned \$159,000 in fees (\$112,000, net of minority interest) on the proceeds from the sale of development rights in fiscal 2005 and 2004 and \$693,000 (\$486,000, net of minority interest) on the proceeds from the sale of interest in leasehold land in the year ended September 30, 2004 were paid to Nearco, Inc., a company controlled by Mr. Terry Johnston, a director of Barnwell and an indirect 21.8% owner of Kaupulehu Developments. Under an agreement entered into in 1987, prior to Mr. Johnston's election to Barnwell's Board of Directors, Barnwell is obligated to pay Nearco 2% of Kaupulehu Developments' gross receipts from the sale of real estate interests, and Cambridge Hawaii Limited Partnership, a 49.9% partner of Kaupulehu Developments in which Barnwell purchased a 55.2% interest in April 2001, is obligated under an agreement entered into in 1987 to pay Nearco 4% of Kaupulehu Developments' gross receipts from the sale of real estate interests. Fees of \$128,000 (\$89,000, net of minority interest) on the proceeds from sales of development rights were paid in the year ended September 30, 2003. The fees represent compensation for promotion and marketing of Kaupulehu Developments' property and were determined based on the estimated fair value of such services. Barnwell believes the fees are fair and reasonable compensation for such services.

Fees were also paid to Nearco for consulting services related to Kaupulehu Developments' leasehold land. In fiscal 2005, 2004 and 2003, consulting service fees paid to Nearco totaled \$268,000, \$273,000 and \$218,000, respectively, and were included in general and administrative expenses. In addition, \$52,000 of fees were paid to Nearco in fiscal 2004 for services related to the closing of the February 2004 sale of an interest in leasehold land. These fees were a direct cost of the sale and accordingly reduced the revenues recognized from the sale under the cost recovery method. Barnwell believes the fees are fair and reasonable compensation for such services.

Contract Drilling

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

Contract drilling revenues increased \$3,954,000 (107%) to \$7,644,000 in fiscal 2005, as compared to \$3,690,000 in fiscal 2004, and contract drilling operating expenses increased \$2,581,000 (81%) to \$5,765,000 in fiscal 2005, as compared to \$3,184,000 in fiscal 2004. Operating profit before general and administrative expenses increased \$1,346,000 (330%) from \$408,000 in fiscal 2004 to \$1,754,000 in fiscal 2005 due to an increase in water well drilling activity and higher margins on contracts performed throughout most of fiscal 2005, as compared to fiscal 2004. 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. Management currently estimates that operating profit will be lower in fiscal 2006 due to lower estimated margins on contracts in backlog.

At September 30, 2005, there was a backlog of nine well drilling contracts and ten pump installation and repair contracts, seven and four of which were in progress as of September 30, 2005. The backlog of contract drilling revenues as of November 30, 2005 was approximately \$3,500,000.

Contract drilling revenues increased \$1,640,000 (80%) to \$3,690,000 in fiscal 2004, as compared to \$2,050,000 in fiscal 2003, and contract drilling operating expenses increased \$1,256,000 (65%) to \$3,184,000 in fiscal 2004, as compared to \$1,928,000 in fiscal 2003. Operating profit before depreciation increased \$384,000 (315%) from \$122,000 in fiscal 2003 to \$506,000 in fiscal 2004. The increases were due to an increase in water well drilling activity as there were four drilling rigs operating at the same time for a portion of fiscal 2004, but not during fiscal 2003.

Gas Processing and Other Income

Gas processing and other income decreased \$388,000 (33%) to \$795,000 in fiscal 2005 as compared to \$1,183,000 in fiscal 2004. In fiscal 2004, Kaupulehu Developments received \$250,000 in income related to negotiations on the development of Kaupulehu Developments' resort/residential acreage; such negotiation revenues discontinued with the consummation of Kaupulehu Developments' sale of an interest in leasehold land in February 2004, therefore there were no such revenues in fiscal 2005. In addition, fiscal 2004 gas processing and other income included a \$139,000 gain from the sale of a parcel of vacant land formerly used as a storage and maintenance yard by Barnwell's contract drilling segment; there was no such sale in fiscal 2005.

Gas processing and other income decreased \$377,000 (24%) to \$1,183,000 in fiscal 2004, as compared to \$1,560,000 in fiscal 2003. In fiscal 2004, Kaupulehu Developments received \$250,000 in income related to negotiations on the development of Kaupulehu Developments' resort/residential acreage, as compared to \$500,000 in fiscal 2003, a decrease of \$250,000; these revenues discontinued with the consummation of Kaupulehu Developments' sale of an interest in leasehold land in February 2004. In addition, interest income decreased in fiscal 2004, as compared to fiscal 2003, as fiscal 2003 interest income included \$102,000 of interest on an income tax refund from the Canadian government relating to Barnwell's fiscal 1994 tax return (there was no such income in fiscal 2004), and as a note receivable that was outstanding during all of fiscal 2003 was repaid in February 2004, which resulted in an approximately \$100,000 decrease in interest income. These decreases were partially offset by an increase in other income in fiscal 2004 from the aforementioned \$139,000 gain from the sale of a parcel of vacant land. The remainder of the decrease was primarily due to a \$30,000 decrease in gas processing fees due to a decrease in the processing of third-party gas, as compared to the prior year.

General and Administrative Expenses

General and administrative expenses increased \$3,820,000 (48%) to \$11,731,000 in fiscal 2005, as compared to \$7,911,000 in fiscal 2004. The increase was due in part to a \$2,509,000 increase in stock appreciation rights expense resulting from an increase in Barnwell's stock price and the issuance of additional stock options with stock appreciation rights in fiscal 2005, as compared to the prior year. Personnel costs also increased by \$1,192,000 in fiscal 2005 as a result of the addition of new personnel in the oil and natural gas operations and increased compensation costs. In addition, professional fees increased \$215,000 in the current year due to higher legal and audit fees, as a result of increased costs of regulatory compliance, and consulting services related to Barnwell's oil and natural gas leases.

General and administrative expenses increased \$1,940,000 (32%) to \$7,911,000 in fiscal 2004, as compared to \$5,971,000 in fiscal 2003. The increase was due to the impact of an increase in Barnwell's stock price on stock appreciation rights, which increased general and administrative expenses by \$765,000 as compared to the prior year, \$733,000 of bonuses issued in conjunction with the consummation of Kaupulehu Developments' sale of an interest in leasehold land in February 2004, and \$443,000 of higher payroll costs, as compared to the prior year.

General and administrative expenses also includes fees paid to Nearco, Inc., an entity controlled by Mr. Terry Johnston, a director of Barnwell and an indirect 21.8% owner of Kaupulehu Developments, for consulting services related to Kaupulehu Developments' leasehold land. Fees paid to Nearco, Inc. totaled \$268,000, \$273,000 and \$218,000 in fiscal 2005, 2004 and 2003, respectively. Barnwell believes the fees are fair and reasonable compensation for such services.

Depletion, Depreciation and Amortization

Depletion, depreciation and amortization increased \$2,027,000 (30%) to \$8,788,000 in fiscal 2005, as compared to \$6,761,000 in fiscal 2004, due to a 17% increase in the depletion rate, a 4% increase in production (in MCF equivalents where one barrel of oil and natural gas liquids are converted to 5.8 MCF equivalents) and an 8% increase in the average exchange rate of the Canadian dollar to the U.S. dollar.

The higher depletion rate is due to increases in Barnwell's costs of finding and developing proven reserves, and costs that are incurred to decrease the rate of production declines or maintain or increase rates of production from reserves found in previous years. Barnwell's cost of finding and developing proven reserves has increased due to the cost of oil and natural gas exploration and development having increased along with product prices, the drilling of unsuccessful wells, and as a portion of recent oil and natural gas capital expenditures were for the development of existing reserves.

Depletion, depreciation and amortization increased \$2,428,000 (56%) to \$6,761,000 in fiscal 2004, as compared to \$4,333,000 in fiscal 2003, due to a 33% increase in the depletion rate, a 9% increase in production, and a 10% increase in the fiscal year average exchange rate of the Canadian dollar to the U.S. dollar.

Interest Expense

Interest expense increased \$129,000 (26%) to \$616,000 in fiscal 2005, as compared to \$487,000 in fiscal 2004, due to higher average interest rates during fiscal 2005 as compared to fiscal 2004.

The average interest rate incurred during fiscal 2005 on Barnwell's borrowings from the Royal Bank of Canada increased to 4.82%, as compared to 3.67% in fiscal 2004. The weighted average balance of outstanding borrowings from the Royal Bank of Canada remained relatively unchanged at approximately \$10,300,000 in fiscal 2005 and 2004.

Interest expense increased \$45,000 (10%) to \$487,000 in fiscal 2004, as compared to \$442,000 in fiscal 2003, as there was no capitalization of interest in fiscal 2004, as compared to \$45,000 of capitalized interest in fiscal 2003.

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

Foreign Currency Fluctuations

In addition to U.S. operations, Barnwell conducts foreign operations in 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 fiscal year average exchange rate of the Canadian dollar to the U.S. dollar increased 8% in fiscal 2005, as compared to fiscal 2004, and the exchange rate of the Canadian dollar to the U.S. dollar increased 9% at September 30, 2005, as compared to September 30, 2004. Accordingly, the assets, liabilities, stockholders' equity and revenues and expenses of Barnwell's subsidiaries operating in Canada have increased. Barnwell's Canadian dollar assets are greater than its Canadian dollar liabilities; therefore, increases in value of the Canadian dollar to the U.S. dollar generate other comprehensive income. The fiscal year average exchange rate of the Canadian dollar to the U.S. dollar increased 10% in fiscal 2004, as compared to fiscal 2003, and the exchange rate of the Canadian dollar to the U.S. dollar increased 7% at September 30, 2004, as compared to September 30, 2003. Other comprehensive income due to foreign currency translation adjustments for fiscal 2005 was \$1,543,000, a \$117,000 decrease from other comprehensive income of \$1,660,000 in fiscal 2004.

Foreign currency transaction gains and losses were not material in fiscal 2005, 2004, and 2003 and are reflected in general and administrative expenses.

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. dollars.

Income Taxes

In November 2003, Royal Assent was received on a bill passed by the Parliament of Canada, which was then enacted into law, to reduce Canada's corporate tax rate on "resource" income (income derived from oil and natural gas operations) over a four-year period beginning January 1, 2003 from 29% to 21% beginning January 1, 2007. Additionally, the bill phases in over the same four-year period tax deductions for royalties, which previously were not tax deductible, and phases out the Resource Allowance deduction along with other changes. Accordingly, during fiscal 2004, Barnwell's Canadian deferred income tax liabilities were reduced by approximately \$1,440,000 due to the reduction in Canada's federal corporate tax rate. There was no benefit attributable to changes in Canada's corporate tax rate on "resource" income in fiscal 2005 or fiscal 2003. Barnwell's Canadian deferred income tax liabilities were also reduced by approximately \$300,000 in fiscal 2004 as a result of the Province of Alberta's reduction of the province's corporate tax rate from 13.0% to 12.5%, effective April 1, 2003 (enacted into law in December 2003), and from 12.5% to 11.5%, effective April 1, 2004 (enacted into law in May 2004). In April 2002, the legislative assembly of the Province of Alberta passed a bill to reduce the province's corporate tax rate from 13.5% to 13.0%, effective April 1, 2002. The bill was enacted into law in December 2002. The reduction in the tax rate reduced Canadian deferred income tax liabilities by approximately \$75,000 in fiscal 2003. There was no such reduction recorded in fiscal 2005.

Environmental Matters

Federal, state, and Canadian governmental agencies issue rules and regulations and enforce laws to protect the environment which are often difficult and costly to comply with and which carry substantial penalties for failure to comply, particularly in regard to the discharge of materials into the environment. The regulatory burden on the oil and gas industry increases its cost of doing business. These laws, rules and regulations affect the operations of Barnwell and could have a material adverse effect upon the earnings or competitive position of Barnwell. Although Barnwell's experience has been to the contrary, there is no assurance that this will continue to be the case.

Inflation

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

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 151, "Inventory Costs, an amendment of Accounting Research Bulletin ("ARB") No. 43, Chapter 4." SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing" to clarify the accounting for abnormal amounts of idle facility expense, freight handling costs, and wasted material (spoilage). SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, SFAS No. 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS No. 151 will be effective for fiscal years beginning after June 15, 2005. Adoption of the provisions of SFAS No. 151 is not expected to have a material impact on Barnwell's financial condition, results of operations, or liquidity.

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment." SFAS No. 123(R) replaces SFAS No. 123, "Accounting for Stock Issued to Employees," and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123(R) requires that compensation costs relating to share-based payment transactions be recognized in the consolidated financial statements. Compensation costs will be measured based on the fair value of the equity or liability instruments issued. SFAS No. 123(R) is effective, as adjusted by the U.S. Securities and Exchange Commission, as of the beginning of the first annual reporting period that begins after June 15, 2005, or for small business filers, as of the beginning of the first annual reporting period that begins after December 15, 2005. Barnwell is currently evaluating the provisions of SFAS No. 123(R) and has not yet determined whether it will use the modified prospective or the modified retrospective methods allowed by SFAS No. 123(R), nor has it determined its impact on its financial condition, results of operations, or liquidity.

In December 2004, the FASB issued SFAS No.152, "Accounting for Real Estate Time-Sharing Transactions -- an amendment of FASB Statements No. 66 and 67." SFAS No. 152 amends SFAS No. 66, "Accounting for Sales of Real Estate," to reference the financial accounting and reporting guidance for real estate time-sharing transactions provided in the American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 04-2, "Accounting for Real Estate Time-Sharing Transactions." SFAS No. 152 also amends SFAS No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects," to state that the guidance for incidental operations and costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. The accounting for such operations and costs is subject to the guidance in SOP 04-2. SFAS No. 152 is effective for financial statements for fiscal years beginning after June 15, 2005, with earlier application encouraged. Adoption of the provisions of SFAS No. 152 is not expected to have a material impact on Barnwell's financial condition, results of operations, or liquidity.

In December 2004, the FASB issued SFAS No. 153, "Exchange of Nonmonetary Assets, an amendment of APB Opinion No. 29, 'Accounting for Nonmonetary Transactions.'" SFAS No. 153 is based on the principle that exchange of nonmonetary assets should be measured based on the fair market value of the assets exchanged. SFAS No. 153 eliminates the exception of nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is effective for nonmonetary asset exchanges in fiscal periods beginning after June 15, 2005. Adoption of the provisions of SFAS No. 153 is not expected to have a material impact on Barnwell's financial condition, results of operations, or liquidity.

On February 7, 2005, the Office of the Chief Accountant of the Securities and Exchange Commission issued a letter to the AICPA expressing its views regarding certain operating lease accounting issues and their application under accounting principles generally accepted in the United States of America. Barnwell's accounting for operating leases was evaluated by Barnwell's management using the guidance provided in this letter, and it was determined that any changes in accounting as a result of the aforementioned letter would not have a material impact on Barnwell's financial condition, results of operations or liquidity.

In March 2005, the FASB issued FASB Interpretation No. 47 ("FIN"), "Accounting for Conditional Asset Retirement Obligations -- an interpretation of FASB Statement No. 143." FIN 47 clarifies that the term "conditional asset retirement obligation" as used in FASB Statement No. 143, "Accounting for Asset Retirement Obligations," refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. FIN 47 is effective for fiscal years ending after December 15, 2005. Adoption of the provisions of FIN 47 is not expected to have a material impact on Barnwell's financial condition, results of operations or liquidity.

On March 29, 2005, the Securities and Exchange Commission ("SEC") staff issued Staff Accounting Bulletin ("SAB") No. 107, "Share-Based Payment", which expressed the SEC staff's views on SFAS No. 123(R), but did not modify any of SFAS No. 123(R)'s provisions. Barnwell is evaluating the views expressed by the SEC in SAB No. 107 in conjunction with its assessment of SFAS No. 123(R)'s impact.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Correction -- a replacement of APB Opinion No. 20 and FASB Statement No. 3." This statement changes the requirements for the accounting for and reporting of a change in accounting principle and applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. APB No. 20 required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This statement requires retrospective application to prior period financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The provisions of SFAS No. 154 are effective for fiscal years beginning after December 15, 2005.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows, Debt and Available Credit

Cash flows provided by operations totaled \$14,213,000 for fiscal 2005, an increase of \$8,065,000 as compared to \$6,148,000 of cash flows provided by operations for the same period in the prior year. The increase was due to higher operating cash flow generated by Barnwell's oil and natural gas and contract drilling segments.

Cash flows used in investing activities totaled \$13,423,000 for fiscal 2005, a decrease of \$14,980,000 from cash flows provided by investing activities of \$1,557,000 in fiscal 2004. The decrease in investing cash flows is primarily due to 1) Kaupulehu Developments' receipt of a closing payment for the sale of an interest in leasehold land in February 2004 which generated approximately \$10,460,000 of cash, net of associated costs, 2) collection in full of a \$1,311,000 note receivable in fiscal 2004, and 3) receipt of \$440,000 of proceeds, net of associated costs, from the sale of land that was previously utilized as a contract drilling storage yard in fiscal 2004; there were no such proceeds received in fiscal 2005. Capital expenditures increased from \$12,109,000 in fiscal 2004 to \$16,715,000 in fiscal 2005, an increase of \$4,606,000. Barnwell also invested \$3,400,000 in certificates of deposit at various financial institutions, partially offset by \$3,087,000 of proceeds received on matured certificates of deposit, in fiscal 2005, as compared to \$1,387,000 of investments in certificates of deposit, net of proceeds from matured certificates of deposit, in fiscal 2004. In both periods Barnwell received \$2,497,000, net of expenses, from the sale of development rights. Barnwell also received a total of approximately \$558,000 related to gas over bitumen royalty adjustments in fiscal 2005; there were no such proceeds received in fiscal 2004.

During fiscal 2005, Barnwell used \$2,000 of cash flows for financing activities, a \$4,944,000 decrease as compared to \$4,946,000 of cash flows used in financing activities in fiscal 2004. This was principally due to Barnwell borrowing \$1,116,000 under the Royal Bank of Canada facility in fiscal 2005, as compared to the repayment of \$1,408,000 of long-term debt in fiscal 2004. In fiscal 2005, Barnwell distributed \$513,000 to minority interests resulting from Kaupulehu Developments' property sales, a \$2,120,000 decrease in minority interest distributions compared to \$2,633,000 in fiscal 2004, as distributions in the prior year included distributions on the aforementioned receipt of a closing payment for the sale of an interest in leasehold land in February 2004. Barnwell also paid \$802,000 in dividends,

a \$321,000 decrease from \$1,123,000 of dividends paid in fiscal 2004, and collected \$197,000 in proceeds from employees' exercise of stock options as compared to \$218,000 collected in fiscal 2004.

On December 3, 2004, Barnwell declared a cash dividend of \$0.04 per share (split-adjusted), payable January 5, 2005, to stockholders of record on December 20, 2004.

Also on December 3, 2004, Barnwell declared a two-for-one stock split in the form of a stock dividend. The new shares were distributed on January 28, 2005 to all shareholders of record as of January 11, 2005.

On February 14, 2005, Barnwell declared a cash dividend of \$0.02 per share (split-adjusted), payable March 15, 2005, to stockholders of record on March 1, 2005.

On May 11, 2005, Barnwell declared a cash dividend of \$0.02 per share (split-adjusted), payable June 15, 2005, to stockholders of record on June 1, 2005.

On August 11, 2005, Barnwell declared a cash dividend of \$0.02 per share (split-adjusted), payable September 15, 2005, to stockholders of record on September 1, 2005.

On October 17, 2005, Barnwell declared a three-for-one stock split in the form of a stock dividend. The new shares were distributed on November 14, 2005 to all shareholders of record as of October 28, 2005.

On December 9, 2005, Barnwell declared a cash dividend of \$0.025 per share payable January 4, 2006, to stockholders of record on December 20, 2005.

The Royal Bank of Canada has renewed Barnwell's credit facility through April 2006 at an unchanged \$19,000,000 Canadian dollars, approximately US\$16,300,000, at September 30, 2005. All other terms of the credit facility remained unchanged upon renewal. The bank affirmed that it will not require any repayments under the facility before October 1, 2006. Accordingly, Barnwell has classified outstanding borrowings under the facility as long-term debt.

At September 30, 2005, Barnwell had \$5,492,000 in cash and cash equivalents, \$1,700,000 in certificates of deposit with maturity dates ranging from October 2005 to September 2006, and approximately \$4,700,000 of available credit under its credit facility with the Royal Bank of Canada. Barnwell believes its future cash flows from operations, land segment sales, and available credit will be sufficient to fund its estimated capital expenditures for at least the next twelve months and meet the repayment schedule on its long-term debt. However, if oil and natural gas production remains at or declines from current levels or oil and natural gas prices decline from current levels, current working capital balances and cash flows generated by operations may not be sufficient to fund Barnwell's current projected level of oil and natural gas capital expenditures, in which case Barnwell may fund capital expenditures with funds generated by land segment sales, long-term debt borrowings, or it may reduce future oil and natural gas capital expenditures. Additionally, if Barnwell's credit facility with a Canadian bank is reduced below the current level of borrowings under the facility after the April 2006 review, Barnwell may be required to reduce expenditures or seek alternative sources of financing to make any required payments under the facility.

Oil and Natural Gas Capital Expenditures

In fiscal 2005, Barnwell's oil and natural gas capital expenditures, including accrued capital expenditures, increased \$6,353,000 (53%) from \$11,876,000 in fiscal 2004 to \$18,229,000 in fiscal 2005. Barnwell participated in drilling 80 (13.5 net) wells, 69 (10.3 net) of which were initially deemed by management to be successful, and replaced 71% of oil production (including natural gas liquids) and 90% of natural gas production. Of these 80 wells in fiscal 2005, Barnwell initiated 27 gross wells (8.8 net wells). Of the \$18,229,000 total oil and natural gas properties investments for fiscal 2005, \$2,695,000 (15%) was for acquisition of leases and lease rentals, \$1,523,000 (8%) was for geological and geophysical costs, \$8,170,000 (45%) was for intangible drilling costs, \$5,080,000 (28%) was for production equipment, and \$761,000 (4%) was for future site restoration and abandonment costs. The major areas of investments in fiscal 2005 were in the Dunvegan, Bonanza, Doris, and Progress areas of Alberta.

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

	2005		2004		2003	
	Gross	Net	Gross	Net	Gross	Net
Exploratory oil and natural gas wells	10	2.9	16	6.1	13	3.6
Development oil and natural gas wells	70	10.6	128	8.5	52	11.1
Successful oil and natural gas wells	69	10.3	134	11.2	53	11.1
Unsuccessful oil and natural gas wells	11	3.2	10	3.4	12	3.6

Barnwell estimates that oil and natural gas capital expenditures for fiscal 2006 will range from \$14,000,000 to \$18,000,000. This estimated amount may increase or decrease as dictated by management's assessment of the oil and natural gas environment and prospects.

SUBMISSION OF AMENDMENT TO BARNWELL'S CERTIFICATE OF INCORPORATION TO A VOTE OF SECURITY HOLDERS

The Board of Directors and the stockholders of Barnwell, on May 11, 2005 and October 7, 2005, respectively, approved an amendment (the "Amendment") to Barnwell's Certificate of Incorporation to increase the authorized number of shares of Barnwell's common stock, par value \$0.50, from 4,000,000 shares to 20,000,000 shares. The Amendment became effective on October 12, 2005 upon the filing of the Amendment with the Secretary of State of the State of Delaware.



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

Report of Independent Registered Public Accounting Firm

The Board of Directors
Barnwell Industries, Inc.:

We have audited the accompanying consolidated balance sheets of Barnwell Industries, Inc. and subsidiaries as of September 30, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended September 30, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Barnwell Industries, Inc. and subsidiaries as of September 30, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2005, in conformity with U.S. generally accepted accounting principles.

As discussed in note 5 to the consolidated financial statements, effective October 1, 2002, the Company changed its method of accounting for asset retirement obligations.

KPMG LLP

Honolulu, Hawaii
December 9, 2005

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

<u>ASSETS</u>	September 30,	
	<u>2005</u>	<u>2004</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 5,492,000	\$ 4,497,000
Certificates of deposit	1,700,000	1,387,000
Accounts receivable, net	8,279,000	5,513,000
Deferred income taxes	3,030,000	1,231,000
Other current assets	<u>1,582,000</u>	<u>1,574,000</u>
TOTAL CURRENT ASSETS	20,083,000	14,202,000
INVESTMENT IN LAND	3,033,000	3,033,000
PROPERTY AND EQUIPMENT, NET	<u>61,861,000</u>	<u>47,852,000</u>
TOTAL ASSETS	<u>\$84,977,000</u>	<u>\$65,087,000</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 5,653,000	\$ 3,142,000
Accrued capital expenditures	4,462,000	2,882,000
Accrued stock appreciation rights	4,371,000	1,115,000
Accrued long-term compensation costs	1,249,000	973,000
Other accrued compensation costs	3,828,000	1,965,000
Other current liabilities	<u>1,720,000</u>	<u>2,794,000</u>
TOTAL CURRENT LIABILITIES	<u>21,283,000</u>	<u>12,871,000</u>
LONG-TERM DEBT	<u>11,576,000</u>	<u>10,165,000</u>
ASSET RETIREMENT OBLIGATION	<u>2,845,000</u>	<u>1,775,000</u>
DEFERRED INCOME TAXES	<u>12,935,000</u>	<u>10,719,000</u>
MINORITY INTEREST	<u>312,000</u>	<u>408,000</u>
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Common stock, par value \$0.50 per share:		
Authorized, 20,000,000 shares;		
8,169,060 issued and outstanding at September 30, 2005,		
7,992,060 issued and outstanding at September 30, 2004	4,085,000	3,996,000
Retained earnings	30,317,000	24,984,000
Accumulated other comprehensive income, net	<u>1,624,000</u>	<u>169,000</u>
TOTAL STOCKHOLDERS' EQUITY	<u>36,026,000</u>	<u>29,149,000</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$84,977,000</u>	<u>\$65,087,000</u>

See Notes to Consolidated Financial Statements

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended September 30,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Revenues:			
Oil and natural gas	\$32,724,000	\$23,840,000	\$19,830,000
Contract drilling	7,644,000	3,690,000	2,050,000
Sale of interest in leasehold land, net	550,000	7,330,000	-
Sale of development rights, net	2,497,000	2,497,000	720,000
Gas processing and other	<u>795,000</u>	<u>1,183,000</u>	<u>1,560,000</u>
	<u>44,210,000</u>	<u>38,540,000</u>	<u>24,160,000</u>
Costs and expenses:			
Oil and natural gas operating	6,899,000	5,973,000	4,672,000
Contract drilling operating	5,765,000	3,184,000	1,928,000
General and administrative	11,731,000	7,911,000	5,971,000
Depletion, depreciation and amortization	8,788,000	6,761,000	4,333,000
Interest expense, net	616,000	487,000	442,000
Minority interest in earnings	<u>417,000</u>	<u>2,207,000</u>	<u>309,000</u>
	<u>34,216,000</u>	<u>26,523,000</u>	<u>17,655,000</u>
Earnings before income taxes	9,994,000	12,017,000	6,505,000
Provision for income taxes	<u>3,967,000</u>	<u>3,307,000</u>	<u>4,185,000</u>
NET EARNINGS	<u>\$ 6,027,000</u>	<u>\$ 8,710,000</u>	<u>\$ 2,320,000</u>
BASIC EARNINGS PER COMMON SHARE	<u>\$ 0.74</u>	<u>\$ 1.10</u>	<u>\$ 0.29</u>
DILUTED EARNINGS PER COMMON SHARE	<u>\$ 0.70</u>	<u>\$ 1.03</u>	<u>\$ 0.28</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:			
BASIC	<u>8,152,531</u>	<u>7,943,682</u>	<u>7,887,060</u>
DILUTED	<u>8,643,032</u>	<u>8,441,372</u>	<u>8,217,567</u>

See Notes to Consolidated Financial Statements

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

	Year ended September 30,		
	2005	2004	2003
Cash flows from operating activities:			
Net earnings	\$ 6,027,000	\$ 8,710,000	\$ 2,320,000
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation, depletion and amortization	8,788,000	6,761,000	4,333,000
Minority interest in earnings	417,000	2,207,000	309,000
Accretion of asset retirement obligation	140,000	100,000	85,000
Sale of development rights, net	(2,497,000)	(2,497,000)	(720,000)
Sale of interest in leasehold land, net	(550,000)	(7,330,000)	-
Deferred income taxes	(1,587,000)	(307,000)	709,000
Gain on sale of contract drilling yard	-	(139,000)	-
Increase (decrease) from changes in current assets and liabilities	<u>3,475,000</u>	<u>(1,357,000)</u>	<u>1,479,000</u>
Net cash provided by operating activities	<u>14,213,000</u>	<u>6,148,000</u>	<u>8,515,000</u>
Cash flows from investing activities:			
Proceeds from matured certificates of deposit	3,087,000	595,000	-
Proceeds from sale of development rights, net	2,497,000	2,497,000	1,997,000
Proceeds from gas over bitumen royalty adjustments	558,000	-	-
Proceeds from sale of interest in leasehold land, net	550,000	10,805,000	-
Proceeds from collection of note receivable	-	1,311,000	70,000
Proceeds from sale of contract drilling yard, net	-	440,000	-
Investments in certificates of deposit	(3,400,000)	(1,982,000)	-
Capital expenditures	<u>(16,715,000)</u>	<u>(12,109,000)</u>	<u>(9,816,000)</u>
Net cash (used in) provided by investing activities	<u>(13,423,000)</u>	<u>1,557,000</u>	<u>(7,749,000)</u>
Cash flows from financing activities:			
Long-term debt borrowings (repayments)	1,116,000	(1,408,000)	(360,000)
Proceeds from exercise of stock options	197,000	218,000	-
Distributions to minority interest partners	(513,000)	(2,633,000)	(275,000)
Payment of dividends	<u>(802,000)</u>	<u>(1,123,000)</u>	<u>-</u>
Net cash used in financing activities	<u>(2,000)</u>	<u>(4,946,000)</u>	<u>(635,000)</u>
Effect of exchange rate changes on cash and cash equivalents	<u>207,000</u>	<u>90,000</u>	<u>28,000</u>
Net increase in cash and cash equivalents	995,000	2,849,000	159,000
Cash and cash equivalents at beginning of year	<u>4,497,000</u>	<u>1,648,000</u>	<u>1,489,000</u>
Cash and cash equivalents at end of year	<u>\$ 5,492,000</u>	<u>\$ 4,497,000</u>	<u>\$ 1,648,000</u>

See Notes to Consolidated Financial Statements

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
 Years ended September 30, 2005, 2004 and 2003

	Shares	Common Stock	Additional Paid-In Capital	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance at September 30, 2002 – as previously reported	1,642,797	\$ 821,000	\$3,139,000		\$19,698,000	\$(3,883,000)	\$(4,854,000)	\$14,921,000
Effect of stock dividends issued to effect stock splits	6,244,263	3,123,000	(3,139,000)		(4,838,000)		4,854,000	-
Comprehensive income:				\$2,320,000	2,320,000			2,320,000
Net earnings								
Other comprehensive income, net of income taxes – foreign				2,392,000		2,392,000		2,392,000
currency translation adjustments				<u>\$4,712,000</u>				
Total comprehensive income								
At September 30, 2003	<u>7,887,060</u>	<u>\$3,944,000</u>	<u>\$ -</u>		<u>\$17,180,000</u>	<u>\$(1,491,000)</u>	<u>\$ -</u>	<u>\$19,633,000</u>

(continued on next page)

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
Years ended September 30, 2005, 2004 and 2003

(continued from previous page)

	Shares	Common Stock	Additional Paid-In Capital	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance at September 30, 2003 – as previously reported	1,642,797	\$ 821,000	\$3,139,000		\$22,018,000	\$(1,491,000)	\$(4,854,000)	\$19,633,000
Effect on beginning balances of stock dividends issued to effect stock splits	6,244,263	3,123,000	(3,139,000)		(4,838,000)		4,854,000	-
Exercise of stock options, 105,000 shares (split-adjusted)	105,000	52,000	166,000					218,000
Tax benefit from employee stock option transactions			51,000					51,000
Effect on current period activity of stock dividends issued to effect stock split			(217,000)		217,000			-
Dividends declared (\$0.14 per share, split-adjusted)					(1,123,000)			(1,123,000)
Comprehensive income:								
Net earnings				\$ 8,710,000	8,710,000			8,710,000
Other comprehensive income, net of income taxes – foreign currency translation adjustments				<u>1,660,000</u> <u>\$10,370,000</u>		1,660,000		1,660,000
Total comprehensive income								
At September 30, 2004	<u>7,992,060</u>	<u>\$3,996,000</u>	<u>\$ -</u>		<u>\$24,984,000</u>	<u>\$ 169,000</u>	<u>\$ -</u>	<u>\$29,149,000</u>

(continued on next page)

BARNWELL INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
Years ended September 30, 2005, 2004 and 2003

(continued from previous page)

	Shares	Common Stock	Additional Paid-In Capital	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance at September 30, 2004 – as previously reported	1,660,297	\$ 830,000	\$3,399,000		\$29,605,000	\$ 169,000	\$(4,854,000)	\$29,149,000
Effect on beginning balances of stock dividends issued to effect stock splits	6,331,763	3,166,000	(3,399,000)		(4,621,000)		4,854,000	-
Exercise of stock options, 177,000 shares net of 30,000 tendered and placed in treasury (split-adjusted)	177,000	89,000	345,000				(237,000)	197,000
Effect on current period activity of stock dividends issued to effect stock split			(345,000)		108,000		237,000	-
Dividends declared (\$0.10 per share, split-adjusted)					(802,000)			(802,000)
Comprehensive income:								
Net earnings				\$6,027,000	6,027,000			6,027,000
Other comprehensive income (loss), net of income taxes:								
Foreign currency translation adjustments, net of \$1,277,000 of taxes				1,543,000		1,543,000		1,543,000
Minimum pension liability adjustment, net of \$44,000 tax benefit				(88,000)		(88,000)		(88,000)
Total comprehensive income				<u>\$7,482,000</u>				
At September 30, 2005	<u>8,169,060</u>	<u>\$4,085,000</u>	<u>\$ -</u>		<u>\$30,317,000</u>	<u>\$1,624,000</u>	<u>\$ -</u>	<u>\$36,026,000</u>

See Notes to Consolidated Financial Statements

BARNWELL INDUSTRIES, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED SEPTEMBER 30, 2005, 2004 AND 2003

1. DESCRIPTION OF THE REPORTING ENTITY AND BUSINESS

The consolidated financial statements include the accounts of Barnwell Industries, Inc. and all majority-owned subsidiaries, including an indirect 77.6%-owned land development general partnership, (collectively referred to herein as "Barnwell"). All significant intercompany accounts and transactions have been eliminated.

During its last three fiscal years, Barnwell was engaged in exploring for, developing, producing and selling oil and natural gas in Canada, investing in leasehold land in Hawaii, and drilling wells and installing and repairing water pumping systems in Hawaii. Barnwell's oil and natural gas activities comprise its largest business segment. Approximately 74% of Barnwell's revenues and 97% of Barnwell's capital expenditures for the fiscal year ended September 30, 2005 were attributable to its oil and natural gas activities. Barnwell's contract drilling activities accounted for 17% of fiscal 2005 revenues; Barnwell's land investment segment revenues accounted for 7% of fiscal 2005 revenues; and other revenues comprised 2% of fiscal 2005 revenues.

2. SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents and Certificates of Deposit

Cash and cash equivalents include cash on hand, demand deposits and short-term investments with original maturities of three months or less. At September 30, 2005, Barnwell had \$1,700,000 of certificates of deposit at various financial institutions with maturities ranging from October 2005 to September 2006. As the original maturities of these certificates of deposit are greater than three months, they are excluded from cash and cash equivalents and are reported separately on the Consolidated Balance Sheets.

Trade Accounts Receivable

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

Oil and Natural Gas Properties

Revenues associated with the sale of oil, natural gas and natural gas liquids are recognized in the consolidated statements of operations when the oil, natural gas and natural gas liquids are delivered and title has passed to the customer.

Barnwell uses the full cost method of accounting under which all costs incurred in the acquisition, exploration and development of oil and natural gas reserves, including costs related to unsuccessful wells and estimated future site restoration and abandonment, are capitalized until such time as the aggregate of such costs net of accumulated depletion and oil and gas related deferred income taxes, on a country-by-country basis, equals the sum of 1) the discounted present value (at 10%), using prices as of the end of the fiscal year on a constant basis, of Barnwell's estimated future net cash flows from estimated production of proved oil and natural gas reserves as determined by independent petroleum engineers, less estimated future expenditures to be incurred in developing and producing the proved reserves but excluding future cash outflows associated with settling asset retirement obligations accrued on the balance sheet; plus 2) the cost of major development projects and unproven properties not subject to depletion, if any; plus 3) the lower of cost or estimated fair value of unproven properties included in costs subject to depletion; less 4) related income tax effects. If net capitalized costs exceed this limit, the excess is expensed. Depletion is computed using the units-of-production method whereby capitalized costs, net of salvage values, plus estimated future costs to develop proved reserves and satisfy asset retirement obligations, are amortized over the total estimated proved reserves on a country-by-country basis. Investments in major development projects are not depleted until either proved reserves are associated with the projects or impairment has been determined. At September 30, 2005 and 2004, Barnwell had no investments in major oil and natural gas development projects that were not being depleted. General and administrative costs related to oil and natural gas operations are expensed as incurred. Proceeds from the disposition of minor producing oil and natural gas properties are credited to the cost of oil and natural gas properties. Gains or losses are recognized on the disposition of significant oil and natural gas properties.

Investment in Land and Revenue Recognition

Barnwell's investment in land is comprised of development rights under option; rights to receive percentage payments on the first increment; leasehold land interests in land zoned resort/residential which are under right of negotiation; and land zoned conservation which is not under option or under a right of negotiation. Investment in land is reported at the lower of the asset carrying value or fair value, less costs to sell, and is evaluated for impairment whenever events or changes in circumstances indicate that the recorded investment balance may not be fully recoverable.

Costs incurred for the acquisition and improvement of leasehold land interests, including capitalized interest, are included in the consolidated balance sheets under the caption "Investment in Land."

Sales of development rights under option and revenues from the sale of Increment I of leasehold land interests are accounted for under the cost recovery method. Under the cost recovery method, no operating profit is recognized until cash received exceeds the cost and the estimated future costs related to the development rights sold.

Contract Drilling

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

Long-lived Assets

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

Drilling Rigs, Other Property and Equipment

Drilling rigs and other property and equipment are stated at cost. Depreciation is computed using the straight-line method based on estimated useful lives.

Inventories

Inventories are comprised of drilling materials and are valued at the lower of weighted average cost or market value.

Environmental

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

Asset Retirement Obligation

On October 1, 2002, Barnwell adopted Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations," which requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. Barnwell's estimated site restoration and abandonment costs of its

oil and natural gas properties are capitalized as part of the carrying amount of oil and natural gas properties and depleted over the life of the related reserves. The liability is accreted at the end of each period through charges to oil and natural gas operating expense. If an obligation is settled for other than the carrying amount of the liability, Barnwell will recognize a gain or loss on settlement.

In September 2004, the Securities and Exchange Commission (“SEC”) released Staff Accounting Bulletin (“SAB”) No. 106 which expresses the SEC’s views regarding the application of SFAS No. 143, “Accounting for Asset Retirement Obligations,” by oil and gas producing companies following the full cost accounting method. SAB No. 106 addresses the calculation of ceiling tests for full-cost oil and gas companies, depreciation, depletion and amortization as affected by the adoption of SFAS No. 143, as well as the related required disclosures. Barnwell adopted the provisions of SAB No. 106 during the year ended September 30, 2004. The adoption of SAB No. 106 had no material impact on Barnwell’s financial condition, results of operations or liquidity.

Income Taxes

Deferred income taxes are determined using the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax impacts of differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Earnings Per Common Share

In December 2004, Barnwell’s Board of Directors declared a two-for-one stock split in the form of a 100% stock dividend. The shares were distributed on January 28, 2005 to all shareholders of record as of January 11, 2005. There were 1,361,510 shares outstanding on January 11, 2005 before the split. Barnwell issued 1,028,223 of new shares and utilized 333,287 shares of treasury stock to execute the stock dividend, resulting in outstanding shares of 2,723,020 following the split. Barnwell’s common stock began trading on a split-adjusted basis on January 31, 2005.

In October 2005, Barnwell’s Board of Directors declared a three-for-one stock split in the form of a 200% stock dividend. The shares were distributed on November 14, 2005 to all shareholders of record as of October 28, 2005. There were 2,723,020 shares outstanding on October 28, 2005. Barnwell issued 5,446,040 of new shares to execute the stock dividend, resulting in outstanding shares of 8,169,060 following the split. Barnwell’s common stock began trading on a split-adjusted basis on November 15, 2005.

All information in this Form 10-KSB has been adjusted to reflect the stock splits for all periods presented.

Basic earnings per share excludes dilution and is computed by dividing net earnings by the weighted-average number of common shares outstanding for the period. Diluted earnings per share includes the potentially dilutive effect of outstanding common stock options and securities which are convertible to common shares.

Reconciliations between the numerator and denominator of the basic and diluted earnings per share computations (split-adjusted) for the years ended September 30, 2005, 2004 and 2003 are as follows:

	September 30, 2005		
	Net Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic earnings per share	<u>\$6,027,000</u>	<u>8,152,531</u>	<u>\$0.74</u>
Effect of dilutive securities - common stock options	<u>-</u>	<u>490,501</u>	
Diluted earnings per share	<u>\$6,027,000</u>	<u>8,643,032</u>	<u>\$0.70</u>

	September 30, 2004		
	Net Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic earnings per share	<u>\$8,710,000</u>	<u>7,943,682</u>	<u>\$1.10</u>
Effect of dilutive securities - common stock options	<u>-</u>	<u>497,690</u>	
Diluted earnings per share	<u>\$8,710,000</u>	<u>8,441,372</u>	<u>\$1.03</u>

	September 30, 2003		
	Net Earnings (Numerator)	Shares (Denominator)	Per-Share Amount
Basic earnings per share	<u>\$2,320,000</u>	<u>7,887,060</u>	<u>\$0.29</u>
Effect of dilutive securities - common stock options	<u>-</u>	<u>330,507</u>	
Diluted earnings per share	<u>\$2,320,000</u>	<u>8,217,567</u>	<u>\$0.28</u>

Assumed conversion of convertible debentures to 40,500 shares (split-adjusted) of common stock was excluded from the computation of diluted earnings per share for the period that the debentures were outstanding during the year ended September 30, 2003 because the effect would have been antidilutive (the convertible debentures were repaid in full on June 30, 2003).

Stock-Based Compensation

Barnwell applies the intrinsic-value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations including Financial Accounting Standards Board Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation," to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation -- Transition and Disclosure," established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation plans. As permitted by existing accounting standards, Barnwell has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123, as amended by SFAS No. 148.

Certain stock options granted by Barnwell include stock appreciation rights. Such options are valued at fair value based on the difference between the per share exercise price of the options and the market price of Barnwell's stock at each period-end for outstanding options, or for exercised options, the difference between the exercise price and the market price at exercise.

The following table illustrates the effect on net earnings and basic and diluted earnings per share (split-adjusted) as if the fair-value-based method had been applied to all stock options granted since October 1, 1995.

	Year ended September 30,		
	2005	2004	2003
Net earnings, as reported	\$ 6,027,000	\$ 8,710,000	\$ 2,320,000
Add: Stock-based employee compensation expense included in reported net earnings, net of related tax effects	2,244,000	636,000	226,000
Deduct: Total stock based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	<u>(2,374,000)</u>	<u>(642,000)</u>	<u>(270,000)</u>
Pro-forma net earnings	<u>\$ 5,897,000</u>	<u>\$ 8,704,000</u>	<u>\$ 2,276,000</u>
Basic Earnings Per Share:			
As reported	<u>\$ 0.74</u>	<u>\$ 1.10</u>	<u>\$ 0.29</u>
Pro forma	<u>\$ 0.72</u>	<u>\$ 1.10</u>	<u>\$ 0.29</u>
Diluted Earnings Per Share:			
As reported	<u>\$ 0.70</u>	<u>\$ 1.03</u>	<u>\$ 0.28</u>
Pro forma	<u>\$ 0.68</u>	<u>\$ 1.03</u>	<u>\$ 0.28</u>

Fair value measurement of options without stock appreciation rights that are included in fiscal 2005 pro-forma net earnings was based on an option-pricing model which included assumptions of a weighted average expected life of 5.57 years, expected volatility of 25%, risk-free interest rate of 4%, and an expected dividend yield of 1%. Fair value measurement of options without stock appreciation rights that are included in fiscal 2004 and fiscal 2003 pro-forma net earnings was based on an option-pricing model which included assumptions of a weighted average expected life of 6.40 years, expected volatility of 30%, risk-free interest rate of 6.3%, and an expected dividend yield of 0%.

Foreign Currency Translation

Assets and liabilities of foreign operations and subsidiaries are translated at the year-end exchange rate and resulting translation gains or losses are accounted for in a stockholders' equity account entitled "accumulated other comprehensive income, net." Operating results of foreign subsidiaries are translated at average exchange rates during the period. Realized foreign currency transaction gains or losses were not material in fiscal years 2005, 2004, and 2003.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results could differ significantly from those estimates. Significant assumptions are required in the valuation of deferred tax assets and proved oil and natural gas reserves, and such assumptions may impact the amount at which deferred tax assets and oil and natural gas properties are recorded.

Reclassifications

Certain reclassifications have been made to the September 30, 2004 and 2003 consolidated financial statements conform to classifications used in the September 30, 2005 consolidated financial statements.

3. ACCOUNTS RECEIVABLE AND CONTRACT COSTS

Accounts receivable are net of allowances for doubtful accounts of \$10,000 as of September 30, 2005 and 2004. Included in accounts receivable are contract retainage balances of \$531,000 and \$242,000 as of September 30, 2005 and 2004, respectively. These balances are expected to be collected within one year, generally within 45 days after the related contracts have received final acceptance and approval.

Costs and estimated earnings on uncompleted contracts are as follows:

	September 30,	
	<u>2005</u>	<u>2004</u>
Costs incurred on uncompleted contracts	<u>\$ 8,854,000</u>	\$4,945,000
Estimated earnings	<u>1,760,000</u>	<u>482,000</u>
	<u>10,614,000</u>	5,427,000
Less billings to date	<u>10,228,000</u>	<u>5,341,000</u>
	<u>\$ 386,000</u>	<u>\$ 86,000</u>

Costs and estimated earnings on uncompleted contracts are included in the consolidated balance sheets as follows:

	September 30,	
	<u>2005</u>	<u>2004</u>
Costs and estimated earnings in excess of billings on uncompleted contracts (included in other current assets)	<u>\$ 758,000</u>	\$ 493,000
Billings in excess of costs and estimated earnings on uncompleted contracts (included in other current liabilities)	<u>(372,000)</u>	<u>(407,000)</u>
	<u>\$ 386,000</u>	<u>\$ 86,000</u>

4. INVESTMENT IN LAND

Background

Barnwell owns a 77.6% controlling interest in Kaupulehu Developments, a Hawaii general partnership that owns interests in leasehold land and development rights for property located approximately six miles north of the Kona International Airport in the North Kona District of the Island of Hawaii. Between 1986 and 1989, Kaupulehu Developments obtained the state and county zoning changes necessary to permit development of the Four Seasons Resort Hualalai at Historic Ka'upulehu and Hualalai Golf Club, which opened in 1996, a second golf course, and single-family and multi-family residential units. These projects were developed on leasehold land acquired from Kaupulehu Developments by Kaupulehu Makai Venture, an unrelated entity that is an affiliate of Kajima Corporation of Japan.

Rezoning and Partial Sale of Interest in Leasehold Land

In 1993, Kaupulehu Developments submitted a rezoning petition to the State Land Use Commission and in 1998, filed an Application for a Project District zoning ordinance and a Special Management Area Use Permit Petition with the County of Hawaii to reclassify conservation-zoned land to zoning which allows resort/residential development. In October 2001, Kaupulehu Developments received final approval for the reclassification.

On February 13, 2004, Kaupulehu Developments entered into a Purchase and Sale Agreement with WB KD Acquisition LLC ("WB") by which Kaupulehu Developments transferred its leasehold interest in approximately 870 acres zoned for resort/residential development, in two increments, to WB. There is no affiliation between Kaupulehu Developments and WB. WB is an affiliate of Westbrook Partners LLC, an affiliate of the developers of the Kuki'o Resort. The first increment ("Increment I") is an area planned for approximately 80 single-family lots and a beach club on the portion of the property bordering the Pacific Ocean. The purchasers of the 80 single-family lots will have the right to apply for membership in the Kuki'o Resort Golf and Beach Club, which is located adjacent to and south of the Four Seasons Resort Hualalai at Historic Ka'upulehu. The second increment ("Increment II") is the remaining portion of the approximately 870-acre property and is zoned for single-family and multi-family residential units and a golf course and clubhouse.

With respect to Increment I, Kaupulehu Developments received a non-refundable \$11,550,000 payment ("Closing Payment") in February 2004 and is entitled to receive payment of the following percentages of the gross proceeds generated from the sale by WB of single-family lots in Increment I ("Percentage Payments"): 9% of the gross proceeds from single-family lot sales up to aggregate gross proceeds of \$100,000,000; 10% of such aggregate gross proceeds greater than \$100,000,000 but less than \$300,000,000; and 14% of such aggregate gross proceeds in excess of \$300,000,000. If prior to December 31, 2005, Kaupulehu Developments has not received Percentage Payments equal to or greater than \$2,500,000 in the aggregate, WB will pay Kaupulehu Developments the amount by which the aggregate amount of all prior Percentage Payments made by WB to Kaupulehu Developments is less than \$2,500,000. If prior to December 31, 2006, Kaupulehu Developments has not received Percentage Payments (including payments in lieu of Percentage Payments as described in the immediately preceding sentence) equal to or greater than \$5,000,000 in the aggregate, then WB will pay Kaupulehu Developments the amount by which the aggregate amount of all such payments is less than \$5,000,000. Until the formal granting of access and utility easements by third parties to WB have been completed, WB is entitled, but not required, to withhold payment of Percentage Payments and the minimum

payments described above to Kaupulehu Developments until WB's aggregate gross proceeds generated by the sale of single-family lots in Increment I exceeds \$75,000,000. As of the date of this filing, Kaupulehu Developments has received no Percentage Payments and it is Barnwell's understanding that the conditions regarding the formal granting of easements are in progress but have not yet been completed. There is no assurance that any of these future payments will be received.

WB also agreed to pay Kaupulehu Developments non-refundable interim payments of \$50,000 per month ("Interim Payments") until the first to occur of the closing of the sale of the 40th single-family lot sold in Increment I or WB's payment to Kaupulehu Developments of a total of \$900,000 in Interim Payments subsequent to February 2004. Kaupulehu Developments received the \$900,000 of Interim Payments in full as of August 2005.

Kaupulehu Developments, WB and The Trustees of The Estate of Bernice Pauahi Bishop ("KS") also entered into an agreement (the "Step-In Rights Agreement") whereby if WB elects not to proceed with development of Increment I within the time frame set forth in the Step-In Rights Agreement, which may be extended by KS, or defaults under the terms of its lease with KS, Kaupulehu Developments would have the right to succeed to WB's development rights and develop the property without any payment to WB.

In March 2004, WB commenced engineering of infrastructure, preparation of covenants, conditions and restrictions for a community association, and preparation of legal documents to enable real estate sales, and broke ground and graded several miles of access roads. In 2004, WB received final subdivision approval from the County of Hawaii for the first phase of 38 lots. In 2005, WB received federal and State of Hawaii approvals to begin marketing the first phase of 38 lots of Increment I. Additionally, during 2004 and 2005, WB excavated, processed and placed material on the single-family lots bringing a majority of the first phase of 38 lots to finished grade.

With respect to Increment II, Kaupulehu Developments and WB agreed to use diligent efforts to negotiate, and attempt to document and enter into, prior to the date which is three (3) years following the closing of the sale of the first single-family lot in Increment I, an agreement with regards to the ownership and development of Increment II. WB, however, may terminate such negotiations at any time without any further obligation. Under the terms of the Step-In Rights Agreement, if at the end of three years following the closing of the sale of the first single-family lot in Increment I the parties have not entered into a definitive agreement with respect to Increment II, the leasehold rights with respect to Increment II will revert to Kaupulehu Developments. In 2005, Kaupulehu Developments and WB held several meetings to discuss possible development scenarios for Increment II. No agreement has been reached with WB for the sale and development of Increment II, although discussions between the parties are ongoing. Accordingly, no revenues or cost of sales have been recognized on Increment II.

The sale of Kaupulehu Developments' interest in Increment I in fiscal 2004 was accounted for by use of the cost recovery method, under which no operating profit is recognized until cash received exceeds the cost and the estimated future costs related to the leasehold interest sold. The revenue from the \$11,550,000 Closing Payment plus \$350,000 of post-closing Interim Payments received in March through September 2004, was reduced by \$693,000 of fees related to the sale, approximately \$402,000 in other costs related to the sale, and \$3,475,000 of previously capitalized costs relating to Increment I. The \$7,330,000 of net revenue from the Closing Payment and Interim Payments for the year ended September 30, 2004 is recorded in the Consolidated Statements of Operations as "Sale of interest in leasehold land, net." Operating profit on the Increment I transaction, after minority interest, totaled approximately \$5,470,000 for the year ended September 30, 2004. During the year ended September 30,

2005, Kaupulehu Developments received additional Interim Payments, before minority interest, totaling \$550,000.

Development Rights Under Option

The development rights held by Kaupulehu Developments are for residentially-zoned leasehold land within and adjacent to the Hualalai Golf Club and are under option to Kaupulehu Makai Venture, an unrelated entity that is an affiliate of Kajima Corporation of Japan. On December 31, 2002, 2003 and 2004, Kaupulehu Makai Venture exercised the portion of its development rights option due on those dates and paid Kaupulehu Developments \$2,125,000 in fiscal 2003 and \$2,656,000 in both fiscal 2005 and 2004. At September 30, 2005, approximately 81 acres remain under option. Barnwell accounts for sales of development rights under option by use of the cost recovery method. Under the cost recovery method, no operating profit is recognized until cash received exceeds the cost and the estimated future costs related to development rights sold. In fiscal 2003, \$1,277,000 of the proceeds from the sales of development rights were applied to reduce the carrying value of the underlying development rights recorded on the Consolidated Balance Sheets under the caption "Investment in land" to zero. Sales of development rights were further reduced in fiscal 2003 by \$128,000 of fees related to the sale and the remaining \$720,000 of sales proceeds is recorded in the Consolidated Statements of Operations for fiscal 2003 as "Sale of development rights, net." In each of fiscal years 2005 and 2004, \$2,656,000 of revenues attributable to the development rights sale were reduced by \$159,000 of fees related to the sale, resulting in net revenues of \$2,497,000 and a \$1,950,000 operating profit, after minority interest, on the transactions. There were no other costs deducted from revenues from the sale of development rights in fiscal 2005 and 2004 as all capitalized costs associated with the development rights were expensed in previous years under the cost recovery method.

The total amount of remaining future development rights option receipts at September 30, 2005, if all options are fully exercised, was \$15,937,500, comprised of six payments of \$2,656,250 due on each December 31 of years 2005 to 2010. In November 2005, Kaupulehu Makai Venture paid Kaupulehu Developments \$2,875,000 upon exercising the portion of its development rights option due on December 31, 2005 of \$2,656,000 and a portion, \$219,000, of its development rights option due on December 31, 2006, bringing the total remaining future development rights option receipts to \$13,063,000. If any annual option payment is not made, the then remaining development right options will expire. There is no assurance that any portion of the remaining options will be exercised.

Fees

The aforementioned \$159,000 in fees (\$112,000, net of minority interest) on the proceeds from the sale of development rights in fiscal 2005 and 2004 and \$693,000 (\$486,000, net of minority interest) on the proceeds from the sale of interest in leasehold land in the year ended September 30, 2004 were paid to Nearco, Inc., a company controlled by Mr. Terry Johnston, a director of Barnwell and an indirect 21.8% owner of Kaupulehu Developments. Under an agreement entered into in 1987, prior to Mr. Johnston's election to Barnwell's Board of Directors, Barnwell is obligated to pay Nearco 2% of Kaupulehu Developments' gross receipts from the sale of real estate interests, and Cambridge Hawaii Limited Partnership, a 49.9% partner of Kaupulehu Developments in which Barnwell purchased a 55.2% interest in April 2001, is obligated under an agreement entered into in 1987 to pay Nearco 4% of Kaupulehu Developments' gross receipts from the sale of real estate interests. Fees of \$128,000 (\$89,000, net of minority interest) on the proceeds from sale of development rights were paid in the year ended September 30, 2003. The fees represent compensation for promotion and marketing of Kaupulehu Developments' property and were determined based on the estimated fair value of such

services. Barnwell believes the fees are fair and reasonable compensation for such services.

Fees were also paid to Nearco for consulting services related to Kaupulehu Developments' leasehold land. In fiscal 2005, 2004 and 2003, consulting service fees paid to Nearco totaled \$268,000, \$273,000 and \$218,000, respectively, and were included in general and administrative expenses. In addition, \$52,000 of fees were paid to Nearco in fiscal 2004 for services related to the closing of the February 2004 sale of an interest in leasehold land. These fees were a direct cost of the sale and accordingly reduced the revenues recognized from the sale under the cost recovery method. Barnwell believes the fees are fair and reasonable compensation for such services.

Interests at September 30, 2005

The interests held by Kaupulehu Developments at September 30, 2005 include the development rights under option; the rights to receive Increment I Percentage Payments; the leasehold land zoned for resort/residential development within Increment II, which is under a right of negotiation with WB; and approximately 1,000 acres of vacant leasehold land zoned conservation. There is no assurance that any future development rights option payments or Percentage Payments will be received, nor is there any assurance that WB will enter into an agreement with Kaupulehu Developments regarding Increment II. These interests relate to land located adjacent to and north of the Four Seasons Resort Hualalai at Historic Ka'upulehu, between the Queen Kaahumanu Highway and the Pacific Ocean. Barnwell's cost of Kaupulehu Developments' interests is included in the September 30, 2005 and 2004 consolidated balance sheets under the caption "Investment in Land" and consists of the following amounts:

	<u>September 30,</u>	
	<u>2005</u>	<u>2004</u>
Leasehold land interests:		
Zoned for resort/residential development – Increment I	\$ -	\$ -
Zoned for resort/residential development – Increment II	2,983,000	2,983,000
Zoned conservation	<u>50,000</u>	<u>50,000</u>
	<u>3,033,000</u>	<u>3,033,000</u>
Development rights under option	-	-
Total investment in land	<u>\$ 3,033,000</u>	<u>\$ 3,033,000</u>

5. PROPERTY AND EQUIPMENT AND ASSET RETIREMENT OBLIGATION

Barnwell's property and equipment is detailed as follows:

	<u>Estimated Useful Lives</u>	<u>Gross Property and Equipment</u>	<u>Accumulated Depreciation, Depletion and Amortization</u>	<u>Net Property and Equipment</u>
<u>At September 30, 2005:</u>				
Land		\$ 365,000	\$ -	\$ 365,000
Oil and natural gas properties (full cost accounting)		126,105,000	(66,705,000)	59,400,000
Drilling rigs and equipment	3 – 7 years	4,303,000	(3,951,000)	352,000
Premises	40 years	857,000	(38,000)	819,000
Other property and equipment	3 – 17 years	<u>3,399,000</u>	<u>(2,474,000)</u>	<u>925,000</u>
Total		<u>\$135,029,000</u>	<u>\$(73,168,000)</u>	<u>\$61,861,000</u>

	Estimated Useful Lives	Gross Property and Equipment	Accumulated Depreciation, Depletion and Amortization	Net Property and Equipment
<u>At September 30, 2004:</u>				
Land		\$ 365,000	\$ -	\$ 365,000
Oil and natural gas properties (full cost accounting)		98,832,000	(53,108,000)	45,724,000
Drilling rigs and equipment	3 – 7 years	4,126,000	(3,906,000)	220,000
Premises	40 years	857,000	(17,000)	840,000
Other property and equipment	3 – 17 years	3,177,000	(2,474,000)	703,000
Total		<u>\$107,357,000</u>	<u>\$(59,505,000)</u>	<u>\$47,852,000</u>

In October 2004, the Government of Alberta enacted amendments to the Natural Gas Royalty Regulation which provide a mechanism to reduce royalties calculated through the Crown royalty system for operators of gas wells which have been denied the right to produce by the Alberta Energy Utilities Board as a result of recent bitumen conservation decisions. In December 2004, royalty reductions were effected by the Alberta Department of Energy's Information Letter 2004-36 which sets out the details of the royalty adjustment, the impact on the existing temporary assistance received to date by affected gas well operators, the provisions for potential recapture of the royalty adjustments, and continuation of impacted petroleum and natural gas agreements. Barnwell received a total of approximately \$558,000 related to the aforementioned royalty adjustments for wells in the Thornbury area in fiscal 2005. It is Barnwell's estimation that the subject Thornbury wells will not recommence production, thus no returns to the Government of Alberta of the royalty adjustments received would be required under the recapture provisions. Accordingly, the receipts are payments for deemed production by the Government of Alberta to Barnwell for condemnation of the wells, and such receipts were credited to oil and natural gas properties for book purposes.

On October 1, 2002, Barnwell adopted Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations," which requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. Adoption of SFAS No. 143 increased gross oil and natural gas properties by \$564,000, decreased accumulated depletion by \$546,000, and increased the asset retirement obligation by \$1,110,000 on October 1, 2002. Following the initial implementation of SFAS No. 143, the asset retirement obligation was increased during the year ended September 30, 2003 by \$39,000 to reflect obligations incurred on new wells drilled, by \$85,000 for accretion of the asset retirement obligation, and by \$198,000 for changes in foreign currency translation rates. During the year ended September 30, 2004, the asset retirement obligation was increased by \$133,000 to reflect obligations incurred on new wells drilled and changes in the timing and amount of estimated future expenditures, by \$100,000 for accretion of the asset retirement obligation, and by \$110,000 for changes in foreign currency translation rates.

During the year ended September 30, 2005, the asset retirement obligation was increased by \$221,000 to reflect obligations incurred on new wells drilled, \$545,000 for changes in the timing and amount of estimated future expenditures, \$140,000 for accretion of the asset retirement obligation, and by \$195,000 for changes in foreign currency translation rates. The changes due to the timing and amount of estimated future expenditures primarily resulted from an increase in the inflation-adjusted cost of abandonment and restoration services, due in part to recent rises in oil and natural gas prices.

The increase was partially offset by \$31,000 in abandonment and restoration disbursements in fiscal 2005.

6. LONG-TERM DEBT

Barnwell has a credit facility at the Royal Bank of Canada, a Canadian bank, for approximately \$16,300,000 at September 30, 2005. Borrowings under this facility were \$11,576,000 and \$10,165,000 at September 30, 2005 and 2004, respectively, and are included in long-term debt. At September 30, 2005, Barnwell had unused credit available under this facility of approximately \$4,700,000.

The facility is available in U.S. dollars at the London Interbank Offer Rate plus 2%, at U.S. prime plus 1%, or in Canadian dollars at Canadian prime plus 1%. A standby fee of 1% per annum is charged on the unused facility balance. Under the financing agreement, the facility is reviewed annually, with the next review planned for April 2006. Subject to that review, the facility may be extended one year with no required debt repayments for one year or converted to a 2-year term loan by the bank. If the facility is converted to a 2-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).

Barnwell has the option to change the currency denomination and interest rate applicable to the loan at periodic intervals during the term of the loan. During the year ended September 30, 2005, Barnwell paid interest at rates ranging from 3.375% to 5.67%. The weighted average interest rate on the facility at September 30, 2005 was 5.61%. The facility is collateralized by Barnwell's interests in its major oil and natural gas properties and a negative pledge on its remaining oil and natural gas properties. The facility is reviewed annually with a primary focus on the future cash flows that will be generated by Barnwell's Canadian oil and natural gas properties. No compensating bank balances are required for this facility.

The bank affirmed that it will not require any repayments under the facility before October 1, 2006. Accordingly, Barnwell has classified outstanding borrowings under the facility as long-term debt.

During the first quarter of fiscal 2003, Barnwell capitalized interest on costs related to its investment in land. Attainment of zoning and development entitlements for Kaupulehu Developments' leasehold land interests in approximately 870 acres of land zoned for resort/residential development was substantially complete as of the end of December 2002. Accordingly, effective January 1, 2003, Barnwell no longer capitalizes interest on the accumulated development costs of the property.

Interest costs for the years ended September 30, 2005, 2004 and 2003 are summarized as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Interest costs incurred	\$616,000	\$487,000	\$487,000
Less interest costs capitalized on investment in land	-	-	45,000
Interest expense	<u>\$616,000</u>	<u>\$487,000</u>	<u>\$442,000</u>

7. TAXES ON INCOME

The components of earnings before income taxes are as follows:

	Year ended September 30,		
	2005	2004	2003
Earnings (loss) before income taxes in:			
United States	\$ (2,091,000)	\$ 3,592,000	\$(2,499,000)
Canada	<u>12,085,000</u>	<u>8,425,000</u>	<u>9,004,000</u>
	<u>\$ 9,994,000</u>	<u>\$12,017,000</u>	<u>\$ 6,505,000</u>

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

	Year ended September 30,		
	2005	2004	2003
Current provision:			
United States – Federal	\$ 310,000	\$ 594,000	\$ 143,000
United States – State	<u>-</u>	<u>28,000</u>	<u>-</u>
	<u>310,000</u>	<u>622,000</u>	<u>143,000</u>
Canadian	<u>5,244,000</u>	<u>2,992,000</u>	<u>3,333,000</u>
Total current	<u>5,554,000</u>	<u>3,614,000</u>	<u>3,476,000</u>
Deferred (benefit) provision:			
United States	(1,338,000)	608,000	(191,000)
Canadian	<u>(249,000)</u>	<u>(915,000)</u>	<u>900,000</u>
Total deferred	<u>(1,587,000)</u>	<u>(307,000)</u>	<u>709,000</u>
	<u>\$ 3,967,000</u>	<u>\$ 3,307,000</u>	<u>\$ 4,185,000</u>

The U.S. deferred tax benefit of \$1,338,000 for fiscal 2005 is primarily the result of increases in stock appreciation rights accruals, bonus accruals, the excess of depletion and depreciation for book purposes over tax, and alternative minimum tax credits generated during the year which are estimated to have future tax benefits.

The U.S. deferred tax expense of \$608,000 for fiscal 2004 includes reversals of temporary differences, resulting from the excess of expenses deductible for tax purposes over expenses recognized under the cost recovery method for books, generated by sales of Kaupulehu Developments' development rights and interest in leasehold land.

Barnwell's Canadian deferred tax benefit of \$915,000 for fiscal 2004 was due to a \$1,740,000 deferred tax benefit resulting from reductions in Canadian federal and provincial tax rates, partially offset by Barnwell's \$825,000 Canadian deferred tax provision resulting from changes in differences between Canadian assets and liabilities for book purposes versus Canadian assets and liabilities for Canadian tax purposes. In November 2003, Royal Assent was received on a bill passed by the Parliament of Canada, which was then enacted into law, to reduce Canada's corporate tax rate on "resource" income (income derived from oil and natural gas operations) over a four-year period beginning January 1, 2003 from 29% to 21% beginning January 1, 2007. Additionally, the bill phases in over the same four-year period tax deductions for royalties, which previously were not tax deductible, and phases out the Resource Allowance deduction along with other changes. Accordingly, during fiscal

2004, Barnwell's Canadian deferred income tax liabilities were reduced by approximately \$1,440,000 due to the reduction in Canada's federal corporate tax rate. There was no benefit attributable to changes in Canada's corporate tax rate on "resource" income in fiscal 2005 or fiscal 2003. Barnwell's Canadian deferred income tax liabilities were also reduced by approximately \$300,000 in fiscal 2004 as a result of the Province of Alberta's reduction of the province's corporate tax rate from 13.0% to 12.5%, effective April 1, 2003 (enacted into law in December 2003), and from 12.5% to 11.5%, effective April 1, 2004 (enacted into law in May 2004). In April 2002, the legislative assembly of the Province of Alberta passed a bill to reduce the province's corporate tax rate from 13.5% to 13.0%, effective April 1, 2002. The bill was enacted into law in December 2002. The reduction in the tax rate reduced Canadian deferred income tax liabilities by approximately \$75,000 in fiscal 2003. There was no such reduction recorded in fiscal 2005.

Barnwell's Canadian deferred tax provision of \$825,000 for fiscal 2004, excluding the deferred tax benefit associated with the aforementioned reduction in income tax rates, and Barnwell's Canadian deferred tax provision for fiscal 2003, were primarily due to Barnwell's Canadian tax deductions related to its oil and natural gas properties exceeding Barnwell's depletion of its oil and natural gas properties for book purposes.

A reconciliation between the reported provision for income taxes and the amount computed by multiplying the earnings before income taxes by the U.S. federal tax rate of 35% is as follows:

	Year ended September 30,		
	2005	2004	2003
Tax expense computed by applying statutory rate	\$ 3,498,000	\$ 4,206,000	\$ 2,277,000
Effect of reduction of Canadian tax rates on Canadian deferred taxes	-	(1,740,000)	(75,000)
Effect of the foreign tax provision, before effect of changes in tax rates, on the total tax provision	302,000	525,000	2,042,000
State net operating losses (generated) utilized	(45,000)	83,000	(39,000)
State income taxes	-	28,000	-
Other	212,000	205,000	(20,000)
	<u>\$ 3,967,000</u>	<u>\$ 3,307,000</u>	<u>\$ 4,185,000</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at September 30, 2005 and 2004 are as follows:

Deferred income tax assets:	<u>2005</u>	<u>2004</u>
U.S. tax effect of deferred Canadian taxes	\$ 3,206,000	\$ 3,028,000
Foreign tax credit carryforwards	4,130,000	4,261,000
Tax basis of investment		
in land in excess of book basis	972,000	1,165,000
Alternative minimum tax credit carryforwards	461,000	116,000
Liabilities accrued for books		
but not for tax under U.S. tax law	3,296,000	1,385,000
Liabilities accrued for books		
but not for tax under Canadian tax law	1,874,000	768,000
Other	<u>564,000</u>	<u>402,000</u>
Total gross deferred tax assets	14,503,000	11,125,000
Less-valuation allowance	<u>(9,703,000)</u>	<u>(8,456,000)</u>
Net deferred income tax assets	<u>4,800,000</u>	<u>2,669,000</u>
Deferred income tax liabilities:		
Property and equipment accumulated		
tax depreciation and depletion		
in excess of book under Canadian tax law	(11,303,000)	(9,675,000)
Property and equipment accumulated		
tax depreciation and depletion		
in excess of book under U.S. tax law	(3,064,000)	(2,141,000)
Other	<u>(338,000)</u>	<u>(341,000)</u>
Total deferred income tax liabilities	<u>(14,705,000)</u>	<u>(12,157,000)</u>
Net deferred income tax liability	<u>\$ (9,905,000)</u>	<u>\$ (9,488,000)</u>

The total valuation allowance increased \$1,247,000 and \$1,790,000 for the years ended September 30, 2005 and 2003, respectively, and decreased \$929,000 for the year ended September 30, 2004. The changes relate primarily to foreign tax credit carryforwards and stock appreciation rights accruals for a Canadian employee for which it is more likely than not that such carryforwards and accruals will not be utilized in the future to reduce Barnwell's U.S. tax obligation.

A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax asset will not be realized. Barnwell has established a valuation allowance primarily for the U.S. tax effect of deferred Canadian taxes, foreign tax credits, accrued expenses and state of Hawaii net operating loss carryforwards which may not be realizable in future years as there can be no assurance of any specific level of earnings or that the timing of U.S. earnings will coincide with the payment of Canadian taxes to enable Canadian taxes to be fully deducted (or recoverable) for U.S. tax purposes.

Net deferred tax assets at September 30, 2005 of \$4,800,000 consists of \$3,322,000 related to expenses accrued for book purposes but not for tax purposes and \$972,000 related to the excess of the cost basis of investment in land for tax purposes over the cost basis of investment in land for book purposes. Canadian deferred tax assets related to expenses accrued for book purposes but not for tax purposes are estimated to be realized through future Canadian income tax deductions against future Canadian oil and natural gas earnings. U.S. deferred tax assets related to expenses accrued for book

purposes but not for tax purposes and the excess of the cost basis of investment in land for tax purposes over the cost basis of investment in land for book purposes are estimated to be realized from deductions against future U.S. earnings from sales of interests in leasehold land and land development rights. Additionally, at September 30, 2005, Barnwell had a deferred tax asset of \$461,000 for alternative minimum tax credit carryforwards which are available to reduce future U.S. federal regular income taxes, over an indefinite period, and a net deferred tax asset of \$45,000 for a state net operating loss carryforward which is available to reduce future state income taxes arising from future sales of interests in leasehold land and land development rights and expires if not utilized on or before September 30, 2025. The amount of deferred income tax assets considered realizable may be reduced if estimates of future taxable income are reduced.

8. PENSION PLAN

Barnwell sponsors a noncontributory defined benefit pension plan covering substantially all of its U.S. employees, with benefits based on years of service and the employee's highest consecutive five-year average earnings. Barnwell's funding policy is intended to provide for both benefits attributed to service to-date and for those expected to be earned in the future.

The overall investment objective of the plan is to provide growth in the assets of the plan to fund future benefit obligations while managing risk in order to meet current benefit obligations. Generally, principal repayments and interest received on government mortgage securities provide cash flows to fund current benefit obligations. Longer-term obligations are generally estimated to be provided for by growth in equity securities. The plan assets at September 30, 2005 were invested as follows: 3% in cash, 3% in a certificate of deposit, 41% in debt securities, and 53% in equity securities. The plan assets at September 30, 2004 were invested as follows: 1% in cash, 3% in a certificate of deposit, 42% in debt securities, and 54% in equity securities. Target asset allocations are not used, and allocations are adjusted from time to time as dictated by current and anticipated market conditions and required cash flows.

The measurement date used to determine pension measures for the pension plan is September 30.

The funded status of the pension plan and the amounts recognized in the consolidated financial statements are as follows:

	September 30,	
	<u>2005</u>	<u>2004</u>
Change in Benefit Obligation:		
Benefit obligation at beginning of year	\$3,392,000	\$3,086,000
Service cost	161,000	121,000
Interest cost	213,000	180,000
Actuarial loss	767,000	125,000
Benefits paid	<u>(121,000)</u>	<u>(120,000)</u>
Benefit obligation at end of year	<u>4,412,000</u>	<u>3,392,000</u>
Change in Plan Assets		
Fair value of plan assets at beginning of year	2,114,000	2,027,000
Actual return on plan assets	186,000	133,000
Employer contribution	150,000	74,000
Benefits paid	<u>(121,000)</u>	<u>(120,000)</u>
Fair value of plan assets at end of year	<u>2,329,000</u>	<u>2,114,000</u>
Funded status	(2,083,000)	(1,278,000)
Unrecognized prior service cost	-	7,000
Unrecognized actuarial loss	<u>1,566,000</u>	<u>853,000</u>
Accrued benefit cost	<u>\$ (517,000)</u>	<u>\$ (418,000)</u>

The accumulated benefit obligation for the pension plan was \$2,978,000 and \$2,357,000 at September 30, 2005 and 2004, respectively. Statement of Financial Accounting Standards No. 132 requires the recognition of a minimum liability equal to the excess, if any, of the accumulated benefit obligation over plan assets. At September 30, 2005, Barnwell recognized an additional minimum liability of \$132,000 as the accrued benefit cost was less than the minimum liability. The increase in the additional minimum liability during the year ended September 30, 2005 was included in other comprehensive income; there was no additional minimum liability as of September 30, 2004.

The actuarial loss of \$767,000 reported above in the "Change in Benefit Obligation" for the year ended September 30, 2005 is principally due to the change from a 5.75% discount rate to a 5.25% discount rate and the actuaries' change from the 1983 mortality table to the 1994 mortality table.

	September 30,	
	<u>2005</u>	<u>2004</u>
Amounts recognized in the consolidated balance sheet consist of:		
Accrued benefit cost, excluding minimum pension liability	\$517,000	\$418,000
Accumulated other comprehensive loss	<u>132,000</u>	<u>-</u>
Net amount recognized	<u>\$649,000</u>	<u>\$418,000</u>
Assumptions used to determine the fiscal year-end benefit obligations:		
Discount rate	5.25%	5.75%
Rate of compensation increase	5.00%	5.00%

	Year ended September 30,		
	2005	2004	2003
Net Periodic Benefit Cost for the Year:			
Service cost	\$ 161,000	\$ 121,000	\$ 128,000
Interest cost	213,000	180,000	171,000
Expected return on plan assets	(171,000)	(157,000)	(144,000)
Amortization of net asset	-	-	(1,000)
Amortization of prior service cost	6,000	6,000	6,000
Amortization of net actuarial loss	40,000	18,000	12,000
Net periodic benefit cost	<u>\$ 249,000</u>	<u>\$ 168,000</u>	<u>\$ 172,000</u>

	Year ended September 30,		
	2005	2004	2003
Assumptions used to determine the net periodic benefit cost:			
Discount rate	5.75%	6.00%	6.50%
Expected return on plan assets	8.00%	8.00%	8.00%
Rate of compensation increase	5.00%	5.00%	5.00%

To develop the expected long-term rate of return on assets assumption, historical returns and the future expectations for returns for each asset class were considered.

Expected Benefit Payments:

Fiscal year ending September 30, 2006	\$ 132,000
Fiscal year ending September 30, 2007	\$ 126,000
Fiscal year ending September 30, 2008	\$ 119,000
Fiscal year ending September 30, 2009	\$ 112,000
Fiscal year ending September 30, 2010	\$ 112,000
Fiscal years ending September 30, 2011 through 2015	\$ 661,000

Barnwell estimates that it will contribute approximately \$300,000 to the plan during fiscal 2006.

9. STOCK OPTIONS

In March 1995, Barnwell granted 120,000 stock options (split-adjusted) to an officer and director of Barnwell under a non-qualified plan at a purchase price of \$3.27 per share (market price on date of grant, split-adjusted). These options had stock appreciation rights that permitted 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. During the year ended September 30, 2004, the officer and director exercised the stock appreciation rights feature of 78,000 shares (split-adjusted) of these options and the difference between the exercise price and the price per share on the dates of exercise (ranging from \$6.99 to \$7.50 per share) was paid to this employee in cash by Barnwell. During the year ended September 30, 2005, the officer and director exercised the stock appreciation rights feature of 42,000 shares (split-adjusted) of these options and the difference between the exercise price and the price per share on the date of exercise (\$14.31 per share, split-adjusted) was paid to this employee in cash by Barnwell. Barnwell recognized \$275,000, \$392,000 and \$101,000 of compensation cost relating to these options in the years ended September 30, 2005, 2004 and 2003, respectively.

In June 1998, Barnwell granted 180,000 stock options (split-adjusted) to an officer of Barnwell's oil and gas segment under a non-qualified plan at a purchase price of \$2.60 per share (market price on date of grant, split-adjusted). These options are fully vested and have stock appreciation rights that permit the holder to receive stock, cash or a combination thereof equal to the amount by which the fair market value, at the time of exercise of the option, exceeds the option price. The options expire in May 2008. Barnwell recognized \$2,223,000, \$599,000 and \$125,000 of compensation costs relating to these options in the years ended September 30, 2005, 2004 and 2003, respectively.

In December 1999, Barnwell granted qualified stock options to certain employees of Barnwell to acquire 408,000 shares and 174,000 shares of Barnwell's common stock (split-adjusted) with an exercise price per share of \$1.98 (market price at date of grant, split-adjusted) and \$2.18 (110% of market price at date of grant, split-adjusted), respectively. These options are fully vested. The \$1.98 per share options expire in December 2009, and the \$2.18 per share options expired in December 2004. During the year ended September 30, 2005, Barnwell issued 207,000 shares of its common stock to certain employees resulting from exercises of qualified stock options at exercise prices ranging from \$1.98 to \$2.18 per share (split-adjusted). During the year ended September 30, 2004, Barnwell issued 105,000 shares of its common stock to certain employees resulting from exercises of qualified stock options at exercise prices ranging from \$1.98 to \$2.18 per share (split-adjusted). No compensation cost was recognized for these options for the years ended September 30, 2005, 2004 and 2003.

In December 2004, Barnwell granted qualified stock options to certain officers/directors of Barnwell to acquire 210,000 shares of Barnwell's common stock at a weighted average exercise price per share of \$9.23 (based on grants at market price and 110% of market price at the date of grant, split-adjusted). These options vest annually over four years commencing one year from the date of grant and expire in December 2014 and December 2009. No compensation cost was recognized for options granted under this plan for the year ended September 30, 2005. At September 30, 2005, 6,000 shares were available for grant under the qualified option plan.

In December 2004, Barnwell granted stock options to certain officers/directors of Barnwell to acquire 210,000 shares of Barnwell's common stock under a non-qualified plan at a purchase price of \$8.80 per share (market price on date of grant, split-adjusted). These options vest annually over five years commencing one year from the date of grant and expire in December 2014. These options have stock appreciation rights that permit the holder to receive stock, cash or a combination thereof equal to the amount by which the fair market value, at the time of exercise of the option, exceeds the option price. Barnwell recognized \$1,001,000 of compensation costs relating to these options in the year ended September 30, 2005.

Stock options at September 30, 2005 (split-adjusted) were as follows:

Range of exercise prices	Options outstanding			Options exercisable	
	Number of Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
\$1.98 - \$2.60	426,000	3.5 years	\$2.24	426,000	\$2.24
\$8.62 - \$9.48	<u>420,000</u>	7.4 years	\$9.02	-	-
\$1.98 - \$9.48	<u>846,000</u>	5.5 years	\$5.61	<u>426,000</u>	\$2.24

Stock options at September 30, 2004 (split-adjusted) were as follows:

Range of exercise prices	Options outstanding			Options exercisable	
	Number of Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
\$1.98 - \$2.60	633,000	3.8 years	\$2.20	633,000	\$2.20
\$3.27	<u>42,000</u>	0.4 years	\$3.27	<u>42,000</u>	\$3.27
\$1.98 - \$3.27	<u>675,000</u>	3.5 years	\$2.26	<u>675,000</u>	\$2.26

Stock options at September 30, 2003 (split-adjusted) were as follows:

Range of exercise prices	Options outstanding			Options exercisable	
	Number of Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
\$1.98 - \$2.60	738,000	4.6 years	\$2.18	598,500	\$2.21
\$3.27	<u>120,000</u>	1.4 years	\$3.27	<u>120,000</u>	\$3.27
\$1.98 - \$3.27	<u>858,000</u>	4.2 years	\$2.33	<u>718,500</u>	\$2.39

There were no forfeitures or expirations of unexercised options in the years ended September 30, 2005, 2004 and 2003.

Barnwell plans to repurchase shares of its common stock from time to time in the open market or in privately negotiated transactions, depending on market conditions. In December 2005, Barnwell's Board of Directors authorized the purchase of up to 250,000 shares.

10. COMMITMENTS AND CONTINGENCIES

Barnwell has committed to compensate its Vice President of Canadian Operations pursuant to a long-term incentive compensation plan, the value of which directly relates to Barnwell's oil and natural gas segment's net income and the change in the value of Barnwell's oil and gas reserves since 1998 with adjustments for changes in natural gas and oil prices and subject to other terms and conditions. Barnwell recognized \$131,000, \$60,000 and \$166,000 of compensation expense pursuant to this incentive plan in fiscal 2005, 2004 and 2003, respectively.

Barnwell has also committed to compensate certain Canadian personnel pursuant to a long-term incentive compensation plan, the value of which directly relates to Barnwell's oil and natural gas segment's net income and the value of Barnwell's oil and gas reserves discovered, commencing in fiscal 2002, for projects developed by such personnel. Barnwell recognized approximately \$90,000, \$190,000 and \$80,000 of costs pursuant to this plan in fiscal 2005, 2004 and 2003, respectively.

Barnwell has several non-cancelable operating leases for office space and leasehold land. Rental expense was \$481,000 in 2005, \$444,000 in 2004, and \$474,000 in 2003. Barnwell is committed under these leases for minimum rental payments summarized by fiscal year as follows: 2006 - \$518,000, 2007 - \$489,000, 2008 - \$451,000, 2009 - \$431,000, 2010 - \$431,000 and thereafter through 2026 an aggregate of \$2,167,000. The lease payments for land are subject to renegotiation after December 31, 2005. Per the lease agreement, the lease payments will remain unchanged pending an appraisal, after which the lease rent could be adjusted to fair market value. Barnwell currently does not know the amount of the new lease payments which could be effective January 1, 2006; they may remain unchanged or increase. The future rental payment disclosures above assume the minimum lease payments for land in effect at December 31, 2005 remain unchanged through December 2025, the end of the lease term.

Barnwell is occasionally involved in routine litigation and is subject to governmental and regulatory controls that are incidental to the ordinary course of business. Barnwell's management believes that all claims and litigation involving Barnwell are not likely to have a material adverse effect on its financial statements taken as a whole.

11. SEGMENT AND GEOGRAPHIC INFORMATION

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

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

	Year ended September 30,		
	2005	2004	2003
Revenues:			
Oil and natural gas	\$32,724,000	\$23,840,000	\$19,830,000
Contract drilling	7,644,000	3,690,000	2,050,000
Land investment	3,047,000	10,077,000	1,220,000
Other	652,000	827,000	720,000
Total before interest income	44,067,000	38,434,000	23,820,000
Interest income	143,000	106,000	340,000
Total revenues	<u>\$44,210,000</u>	<u>\$38,540,000</u>	<u>\$24,160,000</u>
Depletion, depreciation and amortization:			
Oil and natural gas	\$ 8,447,000	\$ 6,423,000	\$ 4,026,000
Contract drilling	125,000	98,000	88,000
Other	216,000	240,000	219,000
Total	<u>\$ 8,788,000</u>	<u>\$ 6,761,000</u>	<u>\$ 4,333,000</u>
Operating profit (loss) (before general and administrative expenses):			
Oil and natural gas	\$17,378,000	\$11,444,000	\$11,132,000
Contract drilling	1,754,000	408,000	34,000
Land investment, net of minority interest	2,378,000	7,612,000	669,000
Other	436,000	587,000	501,000
Total	21,946,000	20,051,000	12,336,000
General and administrative expenses, net of minority interest	(11,479,000)	(7,653,000)	(5,729,000)
Interest income	143,000	106,000	340,000
Interest expense	(616,000)	(487,000)	(442,000)
Earnings before income taxes	<u>\$ 9,994,000</u>	<u>\$12,017,000</u>	<u>\$ 6,505,000</u>
Capital expenditures:			
Oil and natural gas	\$18,229,000	\$11,876,000	\$11,059,000
Land investment	-	-	45,000
Contract drilling	242,000	65,000	72,000
Other	406,000	1,191,000	158,000
Total	<u>\$18,877,000</u>	<u>\$13,132,000</u>	<u>\$11,334,000</u>

Depletion per 1,000 cubic feet ("MCF") of natural gas and natural gas equivalent ("MCFE"), converted at a rate of one barrel of oil and natural gas liquids to 5.8 MCFE, was \$1.66 in fiscal 2005, \$1.31 in fiscal 2004, and \$0.90 in fiscal 2003. The escalating depletion rate is the result of increased costs of finding and developing proven reserves, as compared to prior years, as well as increases in the average exchange rate of the Canadian dollar to the U.S. dollar of 8% in fiscal 2005, as compared to fiscal 2004, and 10% in fiscal 2004, as compared to fiscal 2003.

ASSETS BY SEGMENT:

	September 30,					
	2005		2004		2003	
Oil and natural gas (1)	\$68,592,000	81%	\$50,658,000	78%	\$40,638,000	77%
Contract drilling (2)	2,703,000	3%	3,062,000	5%	1,380,000	3%
Land investment (2)	3,033,000	4%	3,033,000	5%	6,508,000	12%
Other:						
Cash and cash equivalents, and certificates of deposit	7,192,000	8%	5,884,000	9%	1,648,000	3%
Corporate and other	3,457,000	4%	2,450,000	3%	2,463,000	5%
Total	<u>\$84,977,000</u>	<u>100%</u>	<u>\$65,087,000</u>	<u>100%</u>	<u>\$52,637,000</u>	<u>100%</u>

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

(2) Located in Hawaii.

LONG-LIVED ASSETS BY GEOGRAPHIC AREA:

	September 30,					
	2005		2004		2003	
United States	\$ 5,192,000	8%	\$ 4,847,000	10%	\$ 7,640,000	17%
Canada	59,702,000	92%	46,038,000	90%	37,816,000	83%
Total	<u>\$64,894,000</u>	<u>100%</u>	<u>\$50,885,000</u>	<u>100%</u>	<u>\$45,456,000</u>	<u>100%</u>

REVENUE BY GEOGRAPHIC AREA:

	Year ended September 30,		
	2005	2004	2003
United States	\$ 10,803,000	\$ 14,051,000	\$ 3,420,000
Canada	33,264,000	24,383,000	20,400,000
Total (excluding interest income)	<u>\$44,067,000</u>	<u>\$38,434,000</u>	<u>\$23,820,000</u>

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

13. CONCENTRATIONS OF CREDIT RISK

Barnwell's oil and natural gas segment derived 62% of its oil and natural gas revenues in fiscal 2005 from four individually significant customers, ProGas Limited (25%), Glencoe Resources Limited (15%), Coral Energy Canada Inc. (11%), and Plains Marketing Canada, L.P. (11%). At September 30, 2005, Barnwell had a total of \$3,370,000 in receivables from these four customers. In fiscal 2004 Barnwell derived 53% of its oil and natural gas revenues from three individually significant customers. In fiscal 2003 Barnwell derived 64% of its oil and natural gas revenues from four individually significant customers.

Barnwell's contract drilling subsidiary derived 63%, 70%, and 66% of its contract drilling revenues in fiscal 2005, 2004, and 2003, respectively, pursuant to federal, State of Hawaii and county contracts. At September 30, 2005, Barnwell had accounts receivables from the federal, State of Hawaii and county entities totaling approximately \$621,000. Barnwell has lien rights on wells drilled and pumps installed for federal, State of Hawaii, county and private entities.

Historically, Barnwell has not incurred significant credit related losses on its trade receivables, and management does not believe significant credit risk related to these trade receivables exists at September 30, 2005.

14. SUPPLEMENTAL STATEMENTS OF CASH FLOWS INFORMATION

The following details the effect of changes in current assets and liabilities on the consolidated statements of cash flows, and presents supplemental cash flow information:

	Year ended September 30,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Increase (decrease) from changes in:			
Receivables	\$(2,450,000)	\$(2,439,000)	\$ 548,000
Other current assets	151,000	(756,000)	218,000
Accounts payable	2,204,000	(353,000)	(56,000)
Accrued stock appreciation rights	3,036,000	680,000	226,000
Accrued long-term and other compensation costs	1,745,000	654,000	733,000
Other current liabilities	<u>(1,211,000)</u>	<u>857,000</u>	<u>(190,000)</u>
Increase (decrease) from changes in current assets and liabilities	<u>\$ 3,475,000</u>	<u>\$(1,357,000)</u>	<u>\$ 1,479,000</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest (net of amounts capitalized)	<u>\$ 616,000</u>	<u>\$ 448,000</u>	<u>\$ 454,000</u>
Income taxes	<u>\$ 5,293,000</u>	<u>\$ 4,495,000</u>	<u>\$ 2,961,000</u>

Supplemental Disclosure of Non-cash Investing and Financing Activities:

In December 2003, Barnwell purchased the premises and associated fee simple land interest of its corporate office in Honolulu, Hawaii, for \$1,057,000, of which \$883,000 was financed by long-term debt; the debt was subsequently repaid in full in June 2004.

On October 1, 2002, net oil and natural gas properties and the asset retirement obligation increased \$1,110,000 as a result of adoption of Statement of Financial Accounting Standards No. 143.

15. SUBSEQUENT EVENTS

In October 2005, Barnwell declared a three-for-one stock split in the form of a stock dividend. The new shares were distributed on November 14, 2005 to all shareholders of record as of October 28, 2005. All information in this Form 10-KSB has been adjusted to reflect the stock split for all periods presented.

In November 2005, Kaupulehu Makai Venture paid Kaupulehu Developments \$2,875,000 upon exercising the portion of its development rights option due on December 31, 2005 of \$2,656,000 and a portion, \$219,000, of its development rights option due on December 31, 2006.

In December 2005, Barnwell declared a cash dividend of \$0.025 per share payable January 4, 2006, to stockholders of record on December 20, 2005.

Also in December 2005, Barnwell's Board of Directors authorized the repurchase of up to 250,000 shares of Barnwell's common stock from the open market or in privately negotiated transactions.

16. SUPPLEMENTARY OIL AND NATURAL GAS INFORMATION (UNAUDITED)

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

(A) Oil and Natural Gas Reserves

The following table, based on information prepared by independent petroleum engineers, Paddock Lindstrom & Associates Ltd., summarizes changes in the estimates of Barnwell's net interests in total proved reserves of crude oil and natural gas liquids and natural gas ("MCF" means 1,000 cubic feet of natural gas) which are all in Canada:

	OIL (Barrels)	GAS (MCF)
Balance at September 30, 2002	1,527,000	27,166,000
Revisions of previous estimates	(35,000)	(1,035,000)
Extensions, discoveries and other additions	136,000	4,683,000
Less production	<u>(227,000)</u>	<u>(3,175,000)</u>
Balance at September 30, 2003	1,401,000	27,639,000
Revisions of previous estimates	(7,000)	(1,129,000)
Proved undeveloped extensions and other additions	54,000*	1,571,000*
Extensions, discoveries and other additions	115,000	2,127,000
Less production	<u>(259,000)</u>	<u>(3,383,000)</u>
Balance at September 30, 2004	1,304,000	26,825,000
Revisions of previous estimates	76,000	(1,236,000)
Extensions, discoveries and other additions	179,000	3,266,000
Less production	<u>(253,000)</u>	<u>(3,621,000)</u>
Balance at September 30, 2005	<u>1,306,000</u>	<u>25,234,000</u>

* These amounts represent proved undeveloped reserves at Dunvegan added by Paddock Lindstrom & Associates, Ltd. based on a drilling program that commenced and was completed in fiscal 2005. As of September 30, 2005, 2003 and 2002, Paddock Lindstrom & Associates, Ltd. reported no proved undeveloped reserves at Dunvegan.

	OIL (Barrels)	GAS (MCF)
Proved producing reserves at:		
September 30, 2002	<u>1,303,000</u>	<u>19,612,000</u>
September 30, 2003	<u>1,262,000</u>	<u>21,463,000</u>
September 30, 2004	<u>1,135,000</u>	<u>21,614,000</u>
September 30, 2005	<u>1,102,000</u>	<u>21,842,000</u>

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

	September 30,		
	2005	2004	2003
Proved properties	<u>\$117,995,000</u>	\$93,732,000	\$77,913,000
Unproved properties	<u>8,110,000</u>	<u>5,100,000</u>	<u>2,950,000</u>
Total capitalized costs	<u>126,105,000</u>	98,832,000	80,863,000
Accumulated depletion and depreciation	<u>66,705,000</u>	<u>53,108,000</u>	<u>43,404,000</u>
Net capitalized costs	<u>\$ 59,400,000</u>	<u>\$45,724,000</u>	<u>\$37,459,000</u>

(C) Costs Incurred in Oil and Natural Gas Property Acquisition, Exploration and Development

	Year ended September 30,		
	2005	2004	2003
Acquisition of properties:			
Unproved	<u>\$ 2,561,000</u>	<u>\$ 1,882,000</u>	<u>\$ 715,000</u>
Proved	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 635,000</u>
Exploration costs	<u>\$ 3,448,000</u>	<u>\$ 3,460,000</u>	<u>\$2,567,000</u>
Development costs	<u>\$12,220,000</u>	<u>\$ 6,534,000</u>	<u>\$7,142,000</u>

(D) The Results of Operations of Barnwell's Oil and Natural Gas Producing Activities

	Year ended September 30,		
	2005	2004	2003
Gross revenues	<u>\$43,931,000</u>	\$31,776,000	\$26,714,000
Royalties, net of credit	<u>11,207,000</u>	<u>7,936,000</u>	<u>6,884,000</u>
Net revenues	<u>32,724,000</u>	23,840,000	19,830,000
Production costs	<u>6,899,000</u>	5,973,000	4,672,000
Depletion and depreciation	<u>8,447,000</u>	<u>6,423,000</u>	<u>4,026,000</u>
Pre-tax results of operations*	<u>17,378,000</u>	11,444,000	11,132,000
Estimated income tax expense	<u>8,341,000</u>	<u>5,489,000</u>	<u>5,665,000</u>
Results of operations*	<u>\$ 9,037,000</u>	<u>\$ 5,955,000</u>	<u>\$ 5,467,000</u>

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

Revenues and production costs for fiscal 2004 and 2003 reflect reclassifications to conform to the presentation for fiscal 2005.

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

The following tables have been developed pursuant to procedures prescribed by SFAS No. 69, and utilize reserve and production data estimated by petroleum engineers. The information may be useful for certain comparison purposes but should not be solely relied upon in evaluating Barnwell or its performance. Moreover, the projections should not be construed as realistic estimates of future cash flows, nor should the standardized measure be viewed as representing current value.

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

Standardized Measure of Estimated Discounted Future Net Cash Flows

	As of September 30,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Future cash inflows	\$299,383,000	\$168,526,000	\$141,809,000
Future production costs	(52,253,000)	(40,351,000)	(37,439,000)
Future development costs	<u>(2,430,000)</u>	<u>(3,956,000)</u>	<u>(1,231,000)</u>
Future net cash flows before income taxes	244,700,000	124,219,000	103,139,000
Future income tax expenses	<u>(73,367,000)</u>	<u>(35,937,000)</u>	<u>(32,604,000)</u>
Future net cash flows	171,333,000	88,282,000	70,535,000
10% annual discount for timing of cash flows	<u>(51,571,000)</u>	<u>(27,272,000)</u>	<u>(20,998,000)</u>
Standardized measure of estimated discounted future net cash flows	<u>\$119,762,000</u>	<u>\$ 61,010,000</u>	<u>\$ 49,537,000</u>

Changes in the Standardized Measure of Estimated Discounted Future Net Cash Flows

	Year ended September 30,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Beginning of year	<u>\$ 61,010,000</u>	<u>\$49,537,000</u>	<u>\$32,619,000</u>
Sales of oil and natural gas produced, net of production costs	(25,727,000)	(17,875,000)	(15,107,000)
Net changes in prices and production costs, net of royalties and wellhead taxes	68,770,000	16,363,000	18,878,000
Extensions and discoveries	29,958,000	13,304,000*	12,673,000
Purchases of properties	-	-	971,000
Revisions of previous quantity estimates	(4,881,000)	(2,294,000)	771,000
Net change in Canadian dollar translation rate	4,050,000	2,529,000	4,441,000
Changes in the timing of future production and other	100,000	(1,899,000)	(711,000)
Net change in income taxes	(20,159,000)	(3,956,000)	(7,680,000)
Accretion of discount	<u>6,641,000</u>	<u>5,301,000</u>	<u>2,682,000</u>
Net change	<u>58,752,000</u>	<u>11,473,000</u>	<u>16,918,000</u>
End of year	<u>\$119,762,000</u>	<u>\$61,010,000</u>	<u>\$49,537,000</u>

* \$3,260,000 of this amount is derived from proved undeveloped reserves at Dunvegan added by Paddock Lindstrom & Associates, Ltd. based on a planned drilling program which commenced and was completed in fiscal 2005. As of September 30, 2005 and 2003, Paddock Lindstrom & Associates, Ltd. reported no proved undeveloped reserves at Dunvegan.

DIRECTORS AND OFFICERS

BOARD OF DIRECTORS

Erik Hazelhoff-Roelfzema¹ – Investor

Alan D. Hunter, Q.C.^{3,5} – Partner, Code Hunter LLP (Attorneys)

Martin Anderson^{1,2,3} – Partner, Goodsell Anderson Quinn & Stifel (Attorneys)

Murray C. Gardner, Ph.D.^{1,2,3} – Independent Resource Consultant

Terry Johnston² – Investor

Diane G. Kranz^{2,6} – Senior Partner, Kranz & Co., LLP (Accountants)

Kevin K. Takata³ – Deputy Prosecuting Attorney for the City and County of Honolulu

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

Alexander C. Kinzler¹ – President, Chief Operating Officer and General Counsel

Morton H. Kinzler⁴ – Chairman of the Board and Chief Executive Officer

¹Member of the Executive Committee

²Member of the Compensation Committee

³Member of the Audit Committee

⁴Chairman of the Executive Committee

⁵Chairman of the Compensation Committee

⁶Chairperson of the Audit Committee

OFFICERS

Morton H. Kinzler

Chairman of the Board, Chief Executive Officer

Alexander C. Kinzler

President, Chief Operating Officer, General Counsel

Russell M. Gifford

Executive Vice President, Chief Financial Officer, Treasurer, Secretary

Warren D. Steckley

Vice President, Canadian Operations

Mark A. Murashige

Vice President, Controller, Assistant Secretary

Margaret A. Mangan

Assistant Vice President, Assistant Treasurer, Assistant Secretary

Cynthia M. K. Grillot

Assistant Vice President, Assistant Secretary

Joseph R. Downs III

Manager, Information Services

Sheryl A. L. Villanueva

Assistant Controller

Corporate Information

Corporate Headquarters

Barnwell Industries, Inc.
 1100 Alakea Street, Suite 2900
 Honolulu, Hawaii 96813
 Phone (808) 531-8400
 Fax (808) 531-7181

Canadian Office

Barnwell of Canada, Limited
 Suite 900, 639 5th Avenue S.W.
 Calgary, Alberta, Canada T2P 0M9
 Phone (403) 531-1560
 Fax (403) 266-4124

Big Island Office

Water Resources International, Inc.
 P.O. Box 44520, Kamuela Industrial Park
 Kamuela, Hawaii 96743
 Phone (808) 882-7207
 Fax (808) 882-7655

Transfer Agent

American Stock Transfer & Trust Company
 59 Maiden Lane
 New York, New York 10038
 Phone (718) 921-8200
 Website www.amstock.com

Ticker Symbol: BRN
Website: www.brninc.com

Stock Exchange Listing
 American Stock Exchange

Annual Meeting

Barnwell's Annual Meeting of Stockholders will be held on March 6, 2006 at 9:30 a.m., Central Standard Time, in Shreveport, Louisiana.

Market Prices of Common Stock

The following tables reflect the quarterly high and low sales prices, on the American Stock Exchange, for the Company's common stock during the periods indicated:

Quarter ended	High	Low
December 31, 2003	\$ 5.67	\$ 4.13
March 31, 2004	\$ 8.00	\$ 5.23
June 30, 2004	\$ 8.33	\$ 6.87
September 30, 2004	\$ 8.03	\$ 7.00
December 31, 2004	\$12.36	\$ 7.67
March 31, 2005	\$18.62	\$12.08
June 30, 2005	\$24.21	\$17.73
September 30, 2005	\$22.92	\$18.17

Form 10-KSB

Stockholders may obtain a copy of the Company's Form 10-KSB, without charge, by writing to Barnwell Industries, Inc., 1100 Alakea Street, Suite 2900, Honolulu, HI 96813 or by sending an email to brn1@brninc.com or by following the "SEC Filings" link at the Company's website (www.brninc.com).

NOTES



Barnwell Industries, Inc., 1100 Alakea Street, Suite 2900, Honolulu, HI 96813