KESTREL ENERGY INC
Form 10QSB
May 15, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-QSB

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

For the period ended March 31, 2003

or

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

For the transition period from _____________ to __________________

Commission File Number: 0-9261

KESTREL ENERGY, INC.

(Exact name of registrant as specified in its charter)

COLORADO	84-0772451
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1726 COLE BLVD. SUITE 210, LAKEWOOD, CO	80401
(Address of principal executive offices)	(Zip Code)

(303) 295-0344

(Registrant's telephone number, including area code)

999 18TH ST., STE. 2490, DENVER, CO	80202
(Former address of principal executive offices)	(Zip Code)

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

|X| Yes |_| No

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of common stock, as of March 31, 2003: 9,128,400

KESTREL ENERGY, INC.

INDEX TO UNAUDITED FINANCIAL STATEMENTS

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

KESTREL ENERGY, INC.

BALANCE SHEETS AS OF MARCH 31, 2003
AND JUNE 30, 2002
(Unaudited)

	March 31,	June 30,

ASSETS	2003	2002
CURRENT ASSETS:		
Cash and cash equivalents	$ 62,598	$ 56,548
Accounts receivable	262,405	209,016
Other assets	4,510	1,268
Total current assets	329,513	266,832
PROPERTY AND EQUIPMENT, AT COST:		
Oil and gas properties, successful efforts method of accounting:		
Unproved	236,139	215,892
Proved	10,744,612	11,062,848
Pipeline and facilities	807,851	807,851
Furniture and equipment	111,148	135,387
	11,899,750	12,221,978
Accumulated depreciation and depletion	(8,619,054)	(8,880,924)
Net property and equipment	3,280,696	3,341,054
INVESTMENT IN RELATED PARTY	-	356,125
	$ 3,610,209	$ 3,964,011
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Line of credit, bank	$ -	$ 516,000
Accounts payable-related party	20,008	58,368
Accounts payable-trade	395,444	242,208
Accrued liabilities	116,920	81,268
Total current liabilities	532,372	897,844
LONG TERM DEBT:		
Note payable to related party	400,000	-
Total long term debt	400,000	-
STOCKHOLDERS' EQUITY:		
Preferred Stock, $1 par value; 1,000,000 shares authorized, none issued	-	-
Common Stock, no par value; 20,000,000 shares authorized, 9,128,400 and 9,115,200 issued and outstanding at March 31, 2003 and June 30, 2002 respectively	20,059,585	20,043,907
Accumulated other comprehensive loss	-	(523,358)
Accumulated deficit	(17,381,748)	(16,454,382)
Total stockholders' equity	2,677,837	3,066,167
	$ 3,610,209	$ 3,964,011

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See accompanying notes to financial statements.

KESTREL ENERGY, INC.
STATEMENTS OF OPERATIONS FOR THE THREE MONTHS AND NINE MONTHS ENDED MARCH, 2003 AND 2002 (Unaudited)

	Three months ended March 31, 2003	Three months ended March 31, 2002	Nine mon Marc 2003
REVENUE:			
Oil and gas sales	$ 326,821	$ 185,013	$ 828,811
COSTS AND EXPENSES:			
Lease operating expenses	154,055	144,956	425,575
Dry holes, abandoned and impaired properties	-	-	-
Exploration expenses	(193)	24,088	19,222
Depreciation and depletion	46,060	59,312	115,561
General and administrative	157,239	209,147	602,512
TOTAL COSTS AND EXPENSES	357,161	437,503	1,162,870
OTHER INCOME (EXPENSE):			
Gain on disposal of property & equipment	-	2,258	21,869
Loss on disposal of available-for-sale Securities	(483,119)	(183,417)	(575,893)
Interest income	-	-	4,010
Interest expense / loan fees	(14,111)	(34,678)	(93,924)
Other, net	13,996	28,535	50,631
	(483,234)	(187,302)	(593,307)
NET LOSS	(513,574)	(439,792)	(927,366)
OTHER COMPREHENSIVE LOSS			
Unrealized loss from available-for-sale securities	-	(20,369)	-
OTHER COMPREHENSIVE LOSS	$ (513,574)	$ (460,161)	$ (927,366)
NET LOSS PER COMMON SHARE	$ (.06)	$ (.06)	$ (.10)
WEIGHTED AVERAGE COMMON			

SHARES OUTSTANDING	9,118,280	7,718,034	9,116,212
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See accompanying notes to financial statements.

4

KESTREL ENERGY, INC.
STATEMENTS OF CASH FLOWS FOR THE NINE MONTHS ENDED MARCH 31, 2003 AND 2002
(Unaudited)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (927,366)	$ (1,194,148)
Adjustments to reconcile net loss to net cash used in operating activities:		
Dry holes, abandoned and impaired properties	-	2,050
Gain on disposal of property and equipment	(21,869)	(2,258)
Loss on disposal of available-for-sale securities	575,893	403,947
Depreciation and depletion	115,561	177,087
Non-cash interest and loan fees	74,492	-
(Increase) decrease in accounts receivable	(31,957)	129,035
Increase in due from related party	-	(21,303)
(Increase) decrease in other current assets	(3,242)	5,957
Increase in accounts payable-trade	162,226	203,162
Decrease in accounts payable-related party	(38,362)	(26,397)
Increase (decrease) in accrued liabilities	45,348	(28,750)
Net cash used in operating activities	(49,276)	(351,618)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures/acquisition of properties	(93,467)	(78,302)
Proceeds from sale of available-for-sale securities	56,241	544,997
Proceeds from sale of properties and equipment	20,017	-
Net cash provided by (used in) investing activities	(17,209)	466,695
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	-	379,000
Proceeds from exercise of warrants	15,678	-
Advances from related parties	900,000	97,940
Repayment of advances from related party	(327,143)	-
Repayments of borrowings	(516,000)	(906,000)
Borrowings	-	255,382
Net cash provided by (used in) financing		

activities	72,535	(173,678)
Net increase (decrease) in cash and cash equivalents	6,050	(58,601)
Cash and cash equivalents at the beginning of the period	56,548	119,025
Cash and cash equivalents at the end of the period	$ 62,598	$ 60,424
Cash paid for interest	$ 19,432	$ 107,356

See accompanying notes to financial statements.

5

KESTREL ENERGY, INC.

NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

These condensed financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the fiscal year ended June 30, 2002.

In the opinion of management, the accompanying interim unaudited financial statements contain all the adjustments necessary to present fairly the financial position of the Company as of March 31, 2003, the results of operations for the periods shown in the statements of operations, and the cash flows for the periods shown in the statements of cash flows. All adjustments made are of a normal and recurring nature.

Certain amounts in the 2002 financial statements have been reclassified to conform to the 2003 financial statement presentation.

2. Investment in Related Party

The Investment in Related Party at June 30, 2002 represented the Company's investment in Victoria Petroleum, NL ("VP") and was classified as available-for-sale in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Net unrealized gains and losses on the investment were recorded to Other Comprehensive Loss. During the nine months ended March 31, 2003, the Company sold 5.1 million shares of VP for net proceeds of $56,241. In addition, during the quarter ended March 31, 2003, the Company repaid its borrowings from Samson Exploration N.L. (See Note 3 below) by tendering the Company's remaining 25 million-share ownership of VP and additional cash consideration. As a result of these transactions, the Company recognized a cumulative loss of $575,893 on the disposal of VP shares during the nine-months ended March 31, 2003.

3. Borrowings

A. As of June 30, 2002, the Company had an outstanding balance due on its Wells Fargo Line of Credit totaling $516,000, secured by deeds of trust on various of the Company's oil and gas producing properties.

The Line of Credit bore interest at an annual rate of 1.5% over prime, paid monthly. On August 6, 2002 the Company entered into a loan agreement with Samson Exploration N.L. (a related party) and borrowed $500,000. Under the terms of the agreement the Company was required to pay interest at 10% per annum and paid a financing fee of 10% of the borrowed funds. The proceeds from the loan were used to retire the outstanding Line of Credit balance with Wells Fargo.

B. On January 24, 2003 the Company borrowed $400,000 from R&M Oil and Gas LTD (a related party). Under the terms of the loan agreement, the note is due on January 31, 2005 and bears interest at 12.5% per annum and is secured by the Company's oil and gas interests in Grady County, Oklahoma. The proceeds from the loan were used to retire and satisfy the outstanding debt to Samson Exploration N.L. and reduce the Company's accounts payable position at the time.

C. On February 4, 2003, the Company repaid Samson Exploration N.L. in full including all accrued interest and fees with $327,143.15 in cash and the transfer of the Company's remaining 25,000,000 shares of VP common stock (see Note 2 above).

D. On May 5th, 2003, the Company entered into a Line of Credit Agreement with Barry D. Lasker, President and CEO, and borrowed $200,000. Under the terms of the agreement all outstanding amounts are due on May 4th, 2005 and bear interest at 10% per annum. The proceeds of the loan consisted of $50,000 cash and the forgiveness of approximately $150,000 of unpaid

wages and unreimbursed business expenses. The loan is secured by the Company's oil and gas interests in Campbell County, Wyoming.

4. Recent Accounting Pronouncements

Effective July 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) 143 "Accounting for Asset Retirement Obligations". SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company is currently assessing the impact of this statement and, at this time, cannot reasonably estimate the effect of the adoption of SFAS 143 on its financial position, results of operations or cash flows.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2003, the Company had a working capital deficit of $202,859. This compares to the Company's working capital deficit of $631,012 as of June 30, 2002. The decrease in working capital deficit of $428,153 was primarily the result of the repayment of the Company's short-term obligation to Wells Fargo, and then Samson Exploration N.L., with long-term borrowings from R&M Oil and Gas LTD. This benefit, along with increased accounts receivable and cash on hand, was partially offset by increased accounts payable - trade and accrued liabilities. Accounts payable trade consists primarily of unpaid lease operating expenses and increased as a result of higher workover expenses in Wyoming, of which $73,000 remains unpaid at March 31, 2003. As all costs associated with this field are being paid entirely by the non-operating well participants, the funds are accounted for in our increased receivables. Accrued liabilities consist primarily of deferred salary and unreimbursed expenses since May of 2002 due to Barry D. Lasker. These amounts were converted to a line of credit bearing interest at 10% per annum in May, 2003. In order for the Company to fund its working capital deficit, possible steps could include the sale of oil and gas properties or additional issuances of the Company's common stock. The Company continues to rationalize its overhead requirements and is significantly affected by market fluctuations in the prices it receives for sales of its crude oil and natural gas production. Although the Company has restructured a significant current obligation, its liquidity and ability to fund ongoing operations is contingent upon the prices it receives for its commodity production. A decrease in the market price for crude oil or natural gas, or a decrease in production levels on the Company's oil and gas properties, could have a materially adverse impact on the Company's working capital, results of operations and financial condition.

Net cash used by operating activities was $49,276 for the nine months ended March 31, 2003, a decrease of $302,342 from cash used by operating activities during the same period of 2002. This decrease in cash used by operating activities resulted primarily from higher margins (oil and gas sales less lease operating expenses) from the Company's oil and gas production activities.

Net cash used in investing activities was $17,209 for the nine months ended March 31, 2003, versus cash provided of $466,695 for the same period in 2002. During 2003, the Company received $56,241 from the sale of Victoria Petroleum NL ("VP") common stock, versus $544,997 during 2002, and received an additional $20,017 from the sale of non-core, fully depreciated, properties. The Company had capital expenditures totaling $93,467 during the nine-months ended March 31, 2003, versus $78,302 during the same period of 2002, to maintain and enhance the Company's production on several of its core properties.

Cash provided by financing activities totaled $72,535 for the nine months ended March 31, 2003 versus cash used of $173,678 a year ago. During fiscal 2003, the Company repaid Wells Fargo its outstanding indebtedness of $516,000 and borrowed and repaid, with accrued interest and financing fee, $574,492 from Samson Exploration N.L. pursuant to a line of credit agreement entered into on August 6, 2002. The repayment to Samson Exploration N.L. consisted of $327,143.15 in cash, obtained through a subsequent borrowing of $400,000 from R&M Oil and Gas LTD, and the transfer of the Company's remaining interest in VP. The agreement with R&M Oil and Gas LTD calls for interest at 12.5% per annum and has a maturity date of January 31, 2005. In addition, on May 8th, 2003, the Company entered into a Line of Credit Agreement with Barry D. Lasker, President and CEO, and borrowed $200,000. Under the terms of the

agreement, all amounts outstanding are due on May 4th, 2005 and bear interest at 10% per annum. The proceeds of the loan consisted of $50,000 cash and the forgiveness of approximately $150,000 of unpaid wages and unreimbursed business expenses.

RESULTS OF OPERATIONS

The Company reported net losses of $513,574 and $927,366 for the three and nine-month periods ended March 31, 2003, as compared to net losses of $439,792 and $1,194,148 during the comparable periods of 2002. Current period earnings were significantly affected by the realization of $483,119 and $575,893 of losses during the three and nine months ended March 31, 2003, respectively, resulting from the sale of the Company's remaining interests in VP. These losses had been predominately reflected as part of the Company's Accumulated Other Comprehensive Loss on its Balance Sheet at June 30, 2002. These amounts reflect increases of $299,702 and $171,946 over losses recognized on sales of VP shares during the comparable three and nine month periods of 2002. Excluding these items, the Company's results for the quarter and nine months ended March 31, 2003 improved $225,920 and $438,728, respectively, as compared to 2002, on the strength of higher oil and gas prices and lower operating expenses.

The Company's oil and gas revenues for the three months ended March 31, 2003 were $326,821 compared to $185,013 during the same period of 2002, an increase of $141,808 or 77%. The increase in revenues was primarily the result of higher oil and gas prices received during the quarter. Oil and gas production levels were fairly consistent between the two periods. The Company's revenues for the nine-month period ended March 31, 2003 were $828,811 as compared to $752,725 during the same period in 2002, an increase of $76,086, or 10%. The increase in revenues was primarily the result of higher oil and gas prices received during the period. Oil and gas production levels were fairly consistent between the two periods.

The Company's total expenses for the third quarter ended March 31, 2003 decreased $80,342, or 18%, to $357,161 as compared to $437,503 a year ago. The decrease in overall expenses is primarily due to lower exploration, general and administrative costs and lower interest expenses offset by slightly higher lease operating expenses. For the nine months ended March 31, 2003, total expenses decreased $376,979, or 24%, to $1,162,870 as compared to $1,539,849 a year ago. The decrease in expenses was primarily due to lower lease operating and exploration expenses. No expense for dry holes, abandoned or impaired properties was incurred for the three or nine months ended March 31, 2003.

Exploration expenses for the quarter ended March 31, 2003 decreased $24,281. The decrease in costs incurred for the quarter is a result of no exploration activity during the period. For the nine months ended March 31, 2003, exploration expenses decreased $119,030, or 86%, to $19,222 versus $138,252 a year ago. The decrease in exploration expenses reflects a lower level of exploration activities as the Company's current liquidity difficulties have limited its ability to spend discretionary capital.

General and administrative costs for the three months ended March 31, 2003 decreased $51,908, or 25%, to $157,239 as compared to $209,147 for the same period a year ago. The Company's general and administrative expenses for the nine months ended March 31, 2003 decreased $56,940, or 8%, to $602,512 from $659,452. These decreases were primarily attributable to a decrease in salaries and office expenses.

Interest expense and loan fees for the three-month period ended March 31, 2003 decreased $20,567, or 59%, to $14,111 from $34,678 a year ago. The decrease is attributable to lower average borrowings outstanding during the period. For the nine months ended March 31, 2003, interest expense decreased $4,547 or 5%, to $93,924 from $98,471 a year ago. Decreases in interest expense associated with lower average borrowing during this period were offset by loan fees incurred.

CRITICAL ACCOUNTING POLICIES

The Company follows the successful efforts method of accounting for its oil and gas activities. Accordingly, costs associated with the acquisition, drilling and equipping of successful exploratory wells are capitalized. Geological and geophysical costs, delay and surface rentals and drilling costs of unsuccessful exploratory wells are charged to expense as incurred. Costs of drilling development wells, both successful and unsuccessful, are capitalized. Upon the sale or retirement of oil and gas properties, the cost thereof and the accumulated depreciation or depletion are removed from the accounts and any gain or loss is credited or charged to operations.

Depreciation and depletion of capitalized oil and gas properties is computed on the units-of-production method by individual fields as the related proved reserves are produced. A reserve is provided for estimated future costs of site restoration, dismantlement, and abandonment activities, net of residual salvage value, as a component of depletion.

Pipeline and facilities are stated at original cost. Depreciation of pipeline and facilities is provided on a straight-line basis over the estimated useful life of the pipeline of twenty years.

Furniture and equipment are depreciated using the straight-line method over estimated lives ranging from three to seven years.

Management periodically evaluates capitalized costs of unproved properties and provides for impairment, if necessary, through a charge to operations.

Proved oil and gas properties are assessed for impairment on a field-by-field basis. If the net capitalized costs of proved properties exceeds the estimated undiscounted future net cash flows from the property, a provision for impairment is recorded to reduce the carrying value of the property to its estimated fair value.

ITEM 3. Controls and Procedures

Disclosure Controls and Procedures

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and participation of the Company's Chief Executive and Principal Financial Officer (the "Officer") of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-14. Based upon that evaluation, the Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting him to material information relating to the Company required to be included in the Company's periodic SEC filings, including this report.

Internal Controls

There were no significant changes made in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of his evaluation.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS
Not applicable

ITEM 2. CHANGES IN SECURITIES
Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
Not applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS
Not applicable

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits
99.1 Certification of Chief Executive Officer and Principal Financial Officer

(b) Reports on Form 8-K
None

SIGNATURES

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

KESTREL ENERGY, INC.

(Registrant)

Date: MAY 15, 2003

/S/BARRY D. LASKER

Barry D. Lasker
President, Chief Executive Officer,
Principal Financial Officer and
Director

CERTIFICATIONS

I, Barry D. Lasker, certify that:

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

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

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the

registrant as of, and for, the periods presented in this quarterly report;

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

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

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

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

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

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

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

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

/S/BARRY D. LASKER

Barry D. Lasker, President, Chief
Executive Officer, Principal Financial
Officer and Director