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KESTREL ENERGY INC
Form 10QSB
November 13, 2003

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

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

For the period ended SEPTEMBER 30, 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 BOULEVARD, SUITE 210

80401

(Address of principal executive offices)

(Zip Code)

(303) 295-0344

(Registrant's telephone number, including area code)

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

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of common stock, as of
September 30, 2003: 9,798,400

KESTREL ENERGY, INC.

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INDEX TO UNAUDITED FINANCIAL STATEMENTS

	PAGE
PART I. FINANCIAL INFORMATION	
ITEM 1. Financial Statements	
Balance Sheets as of September 30, 2003 (Unaudited) and June 30, 2003	3
Statements of Operations for the Three Months Ended September 30, 2003 and 2002 (Unaudited)	4
Statements of Cash Flows for the Three Months Ended September 30, 2003 and 2002 (Unaudited)	5
Notes to Financial Statements	6
ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	6
ITEM 3. Controls and Procedures	8
PART II. OTHER INFORMATION	
ITEM 1. Legal Proceedings	8
ITEM 2. Changes in Securities	8
ITEM 3. Defaults Upon Senior Securities	8
ITEM 4. Submission of Matters to a Vote of Security Holders	9
ITEM 5. Other Information	9
ITEM 6. Exhibits and Reports of Form 8-K	9
Signatures	10
Certification	11

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

KESTREL ENERGY, INC.

BALANCE SHEETS AS OF SEPTEMBER 30, 2003 AND JUNE 30, 2003

ASSETS	September 30, 2003	June 30, 2003
CURRENT ASSETS:	(Unaudited)	
Cash and cash equivalents	\$ 61,018	\$ 128,604
Accounts receivable	243,121	354,570
Other assets	8,105	18,400
Total current assets	312,244	501,574

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PROPERTY AND EQUIPMENT, AT COST:		
Oil and gas properties, successful efforts method of accounting:		
Unproved	260,355	215,892
Proved	10,940,054	10,918,017
Pipeline and facilities	807,851	807,851
Furniture and equipment	53,363	52,703
	-----	-----
	12,061,623	11,994,463
Accumulated depreciation and depletion	(9,622,022)	(9,577,728)
	-----	-----
Net property and equipment	2,439,601	2,416,735
	-----	-----
	\$ 2,751,845	\$ 2,918,309
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Notes payable-related party	\$ -	\$ 6,556
Accounts payable-trade	313,450	429,663
Accrued Liabilities	82,176	69,998
	-----	-----
Total current liabilities	395,626	506,217
	-----	-----
LONG-TERM LIABILITIES:		
Line of credit-related party	200,000	191,860
Note payable-related party	400,000	400,000
Asset retirement obligation	218,794	216,009
	-----	-----
Total long-term liabilities	818,794	807,869
	-----	-----
Total Liabilities	1,214,420	1,314,086
	-----	-----
STOCKHOLDERS' EQUITY:		
Preferred Stock, \$1 par value; 1,000,000 shares authorized, none issued	-	-
Common Stock, no par value; 20,000,000 shares authorized, 9,798,400 issued and outstanding at September 30, 2003 and June 30, 2003	20,394,585	20,394,585
Accumulated (deficit)	(18,857,160)	(18,790,362)
	-----	-----
Total stockholders' equity	1,537,425	1,604,223
	-----	-----
	\$ 2,751,845	\$ 2,918,309
	=====	=====

See accompanying notes to financial statements.

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KESTREL ENERGY, INC.
 STATEMENTS OF OPERATIONS FOR THE THREE MONTHS ENDED
 SEPTEMBER 30, 2003 AND 2002
 (Unaudited)

	2003	2002
REVENUE:		
Oil and gas sales	\$ 347,510	\$ 252,331
COSTS AND EXPENSES:		
Lease operating Expenses	148,898	111,204
Dry holes, abandoned and impaired properties	-	-
Exploration expenses	12,767	15,522
Depreciation and depletion	47,079	38,958
General and administrative	210,384	234,589
Interest expense	17,734	15,274
	436,862	415,547
OTHER INCOME (EXPENSE)		
Gain on Sale of property and equipment	-	20,017
Gain (loss) on sale of available-for-sale securities	-	(92,774)
Interest income	613	4,010
Other, net	21,941	21,801
	22,554	(46,946)
NET LOSS	(66,798)	(210,162)
OTHER COMPREHENSIVE INCOME (LOSS)		
Unrealized gain (loss) from available-for-sale securities	-	64,390
Comprehensive loss	\$ (66,798)	\$ (145,772)
NET LOSS PER COMMON SHARE	\$ (0.01)	\$ (0.02)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	9,798,400	9,115,200

See accompanying notes to financial statements.

KESTREL ENERGY, INC.
 STATEMENTS OF CASH FLOWS FOR THE THREE MONTHS ENDED

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SEPTEMBER 30, 2003 AND 2002

(Unaudited)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (66,798)	\$ (210,162)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
(Gain) loss on disposal of property	-	(20,017)
(Gain) loss on sale of available for sale securities	-	92,774
Depreciation and depletion	47,079	38,958
Other	1,584	-
(Increase) decrease in accounts receivable	111,449	63,801
(Increase) decrease in other current assets	10,295	150
Increase (decrease) in accounts payable	(116,213)	76,723
Increase (decrease) in accrued liabilities	12,178	(9,316)
Noncash interest expense	-	7,590
	(426)	40,501
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures/acquisition of properties	(67,160)	(52,564)
Proceeds from sale of securities	-	24,744
Proceeds from sale of property	-	20,017
	(67,160)	(7,803)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of debt	-	500,000
Repayments of borrowings	-	(528,460)
	-	(28,460)
Net increase (decrease) in cash and cash equivalents	(67,586)	4,238
Cash and cash equivalents at the beginning of the period	128,604	56,547
Cash and cash equivalents at the end of the period	\$ 61,018	\$ 60,785

See accompanying notes to financial statements.

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, 2003.

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 September 30, 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 recurring nature.

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

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2003, the Company had a working capital deficit of \$83,382. This compares to the Company's working capital deficit of \$4,643 as of June 30, 2003. The increase in working capital deficit of \$78,739 was primarily the result of a decrease of \$189,330 in total current assets including cash and accounts receivable offset by a decrease in trade accounts payable of \$116,213. In order for the Company to fund its working capital deficit, steps may include further sales of non-core properties, further reductions of general and administrative expenses and further equity raising.

Net cash used by operating activities was \$426 for the three months ended September 30, 2003, a decrease of \$40,927 over cash provided by operations of \$40,501 for the same period in 2002. Accounts receivable increased \$66,407, or 38%, to \$243,121 during the period. The increase in accounts receivable was attributable to higher oil and gas revenues during the quarter. Accounts payable decreased \$5,480, or 7%, to \$313,450 during the period versus an increase of \$76,723, or 24%, during the same period a year ago. Accrued liabilities increased \$10,224, or 14%, to \$82,176 during the period versus a decrease of \$9,316 for the period ended September 30, 2002.

Net cash used by investing activities was \$67,160 for the quarter ended September 30, 2003, versus cash used of \$7,803 for the same period in 2002. The increase in cash used resulted from the continued development program of various coalbed methane wells in Wyoming.

No cash was used by financing activities for the three months ended September 30, 2003. For the same period a year ago, \$28,460 of cash was used.

RESULTS OF OPERATIONS

FIRST QUARTER RESULTS

The Company reported a loss of \$66,798, or 1 cent per share, for the three month period ended September 30, 2003. This compares with a loss of \$210,162, or 2 cents per share, for the same period a year ago. The decreased loss in the current period is a result of higher oil and gas sales versus a year ago along with no loss on sale of available for sale securities for the three months ended

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September 30, 2003.

The Company's revenues for the three months ended September 30, 2003 were \$347,510 compared to \$252,331 during the same period of 2002, an increase of \$95,179, or 38%. The increase in oil and gas revenues is attributable to higher oil and gas prices for the quarter ended September 30, 2003 versus the same period one year ago.

The Company's total expenses increased \$21,315, or 5%, to \$436,862 as compared to \$415,547 a year ago. The increase in overall expenses is largely attributable to higher lease operating expense, depletion

6

and interest expense offset by lower exploration expense and general and administrative expense as discussed below. Production and operating expenses increased \$37,694, or 34%, to \$148,898 versus \$111,204 for the same period a year ago. The increase in production and operating expenses was primarily due to higher costs at the Company's Hilight CBM field due to a higher number of producing wells.

No dry holes, abandoned and impaired properties expense was recorded for the three months ended September 30, 2003.

Exploration expenses decreased \$2,755, or 18%, to \$12,767 from \$15,522 a year ago. The decrease is attributable to lower engineering and contract land expenses and no geological and geophysical expenses.

General and administrative costs decreased \$24,205, or 10%, to \$210,384 as compared to \$234,589 for the same period a year ago. The decrease in expenses, though not attributable to any particular expense item, is representative of the Company's ongoing program to lower expenses.

Interest expense increased \$2,460 to \$17,734 from \$15,274 a year ago. The increase in interest expense is due to the conversion of the previous Wells Fargo debt into the current loan from R&M Oil and Gas, Ltd., of which Timothy L. Hoops, one of the Company's directors and its Operations Manager, is a partner, effective January 24, 2003, and the \$200,000 Line of Credit owed to Barry D. Lasker, President and CEO of Kestrel, effective May 15th 2003.

Total other income (expense) items increased \$69,500, or 148%, to a gain of \$22,554 versus a loss of \$46,946 for the same period a year ago. The increase is attributed to loss on available for sale securities during the quarter ended September 30, 2002, with no such loss on sales in the current period.

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

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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

7

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

The Company previously disclosed that, in May of 2000, it received a notice letter from the U.S. Environmental Protection Agency ("EPA") stating that the Company is a potentially responsible party under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA") for the Casmalia Waste Disposal Site in Santa Barbara County, California. The Company also disclosed that it does not believe that it has any liability under CERCLA for wastes disposed at Casmalia and that the EPA's notice was issued in error. In particular, the Company believes that the EPA contacted Kestrel because it was concerned that the Company was the successor in interest to Royal Resources, Inc. and related companies which were alleged to have participated in dumping at the Casmalia site. In fact, the Company is not a successor to Royal Resources or any such related company and has so informed the EPA.

The Company has not received any further communications from the EPA concerning this alleged liability since 2001 when it denied any successor liability and

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declined to sign an agreement proffered by the EPA which would have tolled the statute of limitations for any such claims. The Company believes that the actual successor in interest to Royal Resources ("Royal"), which has agreed to indemnify the Company for any losses the Company may incur a result of this matter, did sign such a tolling agreement. Moreover, the Company has recently learned that Royal and 35 other companies who were, like the Company and Royal, contacted by the EPA in 2000 as potentially responsible parties ("PRPs") entered into a Partial Consent Decree in September of 2002 with the EPA calling for the payment of \$25.3 million in remediation costs and that a similar settlement for \$12.5 million is anticipated with the State of California.

Based on (1) the actual non-involvement of the Company and its predecessors in the activity at the Casmalia site, (2) the failure of the EPA to bring any action against the Company notwithstanding the Company's refusal to agree to an extension of the statute of limitations, (3) the indemnification of the Company by Royal, and (4) the settlement by Royal with the EPA, the Company's management believes that any further action against the Company by the EPA is very unlikely. Management also believes that the likelihood of an material adverse effect on the Company's financial position, results of operations, or cash flows from this matter is remote.

ITEM 2. CHANGES IN SECURITIES

Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

8

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

EXHIBIT NO.	DESCRIPTION
31	Certificate of Chief Executive and Principal Financial Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K - None

9

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.

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KESTREL ENERGY, INC.
(Registrant)

Date: NOVEMBER 13, 2003

/S/BARRY D. LASKER

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