KESTREL ENERGY INC
Form 10QSB
May 13, 2004

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 quarterly period ended MARCH 31, 2004

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 small business issuer 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
(Issuer's telephone number, including area code)

Check whether the issuer (1) 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, 2004:
9,798,400

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, 2004 AND JUNE 30, 2003

	March 31, 2004	June 30, 2003
ASSETS		

CURRENT ASSETS:	(Unaudited)	
Cash and cash equivalents	$ 68,171	$ 128,604
Accounts receivable	299,706	354,570
Other assets	12,196	18,400
Total current assets	380,073	501,574
PROPERTY AND EQUIPMENT, AT COST:		
Oil and gas properties, successful efforts method of accounting:		
Unproved	260,355	215,892
Proved	11,014,381	10,918,017
Pipeline and facilities	807,851	807,851
Furniture and equipment	53,801	52,703
	12,136,388	11,994,463
Accumulated depreciation and depletion	(9,719,130)	(9,577,728)
Net property and equipment	2,417,258	2,416,735
	$ 2,797,331	$ 2,918,309
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Note payable-related party	$ -	$ 6,556
Accounts payable-trade	410,369	429,663
Accounts payable-related party	36,823	-
Accrued liabilities	66,522	69,998
Total current liabilities	513,714	506,217
LONG-TERM LIABILITIES:		
Note payable-Related party	$ 200,000	$ 191,860
Note payable-other	400,000	400,000
Asset retirement obligation	224,365	216,009
Total long-term liabilities	824,365	807,869
Total Liabilities	1,338,079	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 March 31, 2004 and June 30, 2003	20,394,585	20,394,585
Accumulated (deficit)	(18,935,333)	(18,790,362)
Total stockholders' equity	1,459,252	1,604,223
	$ 2,797,331	$ 2,918,309

See accompanying notes to financial statements.

KESTREL ENERGY, INC.

STATEMENTS OF OPERATIONS FOR THE THREE MONTHS AND NINE MONTHS ENDED MARCH, 2004 AND 2003
(Unaudited)

	Three months ended March 31, 2004	Three months ended March 31, 2003	Nine months ended March 31, 2004	Nine months ended March 31, 2003
REVENUE:				
Oil and gas sales	$ 343,183	$ 326,821	$1,082,630	$ 828,811
COSTS AND EXPENSES:				
Lease operating expenses	158,370	154,055	528,776	425,575
Dry holes, abandoned and impaired properties	-	-	52,438	-
Exploration expenses	14,432	(193)	28,355	19,222
Depreciation and depletion	52,307	46,060	149,757	115,561
General and administrative	143,150	157,239	520,280	602,512
Interest / loan expense	16,331	14,111	51,866	93,924
TOTAL COSTS AND EXPENSES	384,590	371,272	1,331,472	1,256,794
OTHER INCOME (EXPENSE):				
Gain on disposal of property & equipment	-	-	-	21,869
Loss on disposal of available-for-sale Securities	-	(483,119)	-	(575,893)
Interest income	-	-	614	4,010
Other, net	17,838	13,996	103,256	50,631
	17,838	(469,123)	103,870	(499,383)
NET LOSS	$ (23,569)	$ (513,574)	$ (144,972)	$ (927,366)
NET LOSS PER COMMON SHARE	$ 0	$ (.06)	$ (.01)	$ (.10)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	9,798,400	9,118,280	9,798,400	9,116,212

See accompanying notes to financial statements.

KESTREL ENERGY, INC.
STATEMENTS OF CASH FLOWS FOR THE NINE MONTHS ENDED MARCH 31, 2004 AND 2003
(Unaudited)

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(144,972)	$ (927,366)
Adjustments to reconcile net loss to net cash used in operating activities:		
Gain on disposal of property and equipment	-	(21,869)
Loss on disposal of available-for-sale securities	-	575,893
Depreciation and depletion	149,757	115,561
Other	1,584	-
(Increase) decrease in accounts receivable	54,864	(31,957)
(Increase) decrease in other current assets	6,204	(3,242)
Increase (decrease) in accounts payable-trade	(19,293)	162,226
Increase in accounts payable-related party	36,823	(38,362)
Non-cash interest and loan fees	-	74,492
Increase (decrease) in accrued liabilities	(3,475)	45,348
Net cash provided by (used in) operating activities	81,492	(49,276)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures/acquisition of properties	(141,925)	(93,467)
Proceeds from sale of available-for-sale securities	-	56,241
Proceeds from sale of properties and equipment	-	20,017
Net cash (used in) investing activities	(141,925)	(17,209)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of warrants	-	15,678
Advances from related parties	-	900,000
Repayment of advances from related party	-	(327,143)
Repayments of borrowings	-	(516,000)
Borrowings	-	-
Net cash provided by financing activities	-	72,535
Net increase (decrease) in cash and cash equivalents	(60,433)	6,050
Cash and cash equivalents at the beginning of the period	128,604	56,548
Cash and cash equivalents at the end of the period	$ 68,171	$ 62,598
Cash paid for interest	$ 51,867	$ 19,432

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 March 31, 2004, 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.

2. Classification of Leasehold Cost

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations," which requires the purchase method of accounting for business combinations initiated after June 30, 2001, and eliminates the pooling-of-interests method. In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets," which discontinues the practice of amortizing goodwill and indefinite lived intangible assets and initiates an annual review for impairment. Intangible assets with a determinable useful life will continue to be amortized over the period. The oil and gas industry is currently discussing the appropriate balance sheet classification of oil and gas mineral rights held by lease or contract. The Company classifies these assets as a component of oil and gas properties in accordance with its interpretation of SFAS No. 19 and common industry practice. There is also a view that these mineral rights are intangible assets as defined in SFAS No. 141, "Business Combinations", and, therefore, should be classified separately on the balance sheet as intangible assets.

The Company did not change or reclassify contractual mineral rights included in oil and gas properties on the balance sheet upon adoption of SFAS No. 141. The Company believes its current accounting of such mineral rights, as part of oil and gas properties is appropriate under the full cost method of accounting. However, if the accounting for mineral rights held by lease or contract is ultimately changed so that costs associated with mineral rights not held under fee title are, pursuant to the guidelines of SFAS No. 141, required to be classified as long term intangible assets, then the reclassified amount as of December 31, 2003 would be approximately $1,769,889 and the reclassified amount as of June 30, 2003 (the end of the Company's last completed fiscal year) would be approximately $1,723,858. Management does not believe that the ultimate outcome of this accounting issue will have a significant impact on the Company's cash flows, results of operations or financial condition.

3. Asset Retirement Obligation

In 2001, FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement requires companies to record the present value of obligations associated with the retirement of tangible long-lived assets in the period in which it is incurred. The liability is capitalized as part of the related long-lived asset's carrying amount. Over time, accretion of the liability is recognized as an operating expense and the capitalized cost is depreciated over the expected useful life of the related asset. The Company's asset retirement obligations relate primarily to the plugging, dismantlement, removal, site reclamation and similar activities of its oil and gas properties. Prior to adoption of this statement, such obligations were accrued ratably over the productive lives of the assets through its depreciation, depletion and amortization for oil and gas properties without recording a separate liability for such amounts.

The transition adjustment related to adopting SFAS No. 143 on July 1, 2002, was recognized as a cumulative effect of a change in accounting principle. The cumulative effect on net income of

adopting SFAS No. 143 was a net favorable effect of $10,890. At the time of adoption, total assets increased $117,147, and total liabilities increased $205,842. The amounts recognized upon adoption are based upon numerous estimates and assumptions, including future retirement costs, future recoverable quantities of oil and gas, future inflation rates and the credit-adjusted risk-free interest rate. Changes in asset retirement obligations during the year were:

Asset retirement obligations as of July 1, 2003	$ 216,009
Liabilities incurred	--
Liabilities settled	--
Accretion expense (included in depreciation, depletion and amortization)	8,356
Asset retirement obligations as of March 31, 2004	$ 224,365

ITEM 2. Management's Discussion and Analysis of Financial Condition or Plan of Operation.

OVERVIEW

During the Quarter the Company has continued its drive to cut costs and maximize revenues. We are pleased to show continued improvement in our bottom line and we can now look to the future with a sound asset base and two excellent high reward-potential projects under our belt. In addition, the development of our Hilight coalbed methane (CBM) play in Campbell County, Wyoming has continued to provide us with a steady increase in reserves and revenues.

This report contains forward-looking statements. We use words such as "anticipate", "believe", "expect", "future", "may", "will", "should", "plan", "intend", and similar expressions to identify forward-looking statements. These statements are based on our beliefs and the assurances we made using information currently available to us. Because these statements reflect our current views concerning future events, these statements involve risks, uncertainties and assumptions. Our actual results could differ materially from the results discussed in the forward-looking statements. Some, but not all, of the factors that may cause these differences include those discussed in the risk factors in the Company's report on Form 10-KSB for the fiscal year ended June 30, 2003. You should not place undue reliance on these forward-looking statements. You should also remember that these statements are made only as of the date of this report and future events may cause them to be less likely to prove to be true.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2004, the Company had a working capital deficit of $133,641. This compares to the Company's working capital deficit of $4,643 as of June 30, 2003. The increase in working capital deficit of $129,000 was the result of an increase of $36,823 in Accounts payable-related party along with decreased accounts receivable and cash on hand. This was partially offset by decreased accounts payable - trade and accrued liabilities. Accounts payable-related party consists primarily of deferred salary and unreimbursed expenses since August 2003 due to Barry D. Lasker. Accounts payable trade consists primarily of unpaid lease operating expenses as a result of higher workover expenses in Wyoming.

Net cash provided by operating activities was $81,492 for the nine months ended March 31, 2004, an increase of $130,768 from cash used by operating activities during the same period of 2003. This increase in cash provided by operating activities resulted primarily from higher profit margins (oil and gas sales less lease operating expenses) from the Company's oil and gas production activities.

Net cash used by investing activities was $141,925 for the nine months ended March 31, 2004, versus cash provided of $17,209 for the same period in 2003. During 2004, the Company had capital expenditures totaling $141,925 during the nine-months ended March 31, 2004, versus $93,467 during the same period of 2003, to maintain and enhance the Company's production on several of its core properties.

There was no cash used or provided by financing activities for the nine months ended March 31, 2004 versus cash provided of $72,535 a year ago.

RESULTS OF OPERATIONS

The Company reported net losses of $23,569 and $144,972 for the three and nine-month periods ended March 31, 2004, as compared to net losses of $513,574 and $927,366 during the comparable periods of 2003. The Company's results for the quarter and nine months ended March 31, 2004 improved $490,005 and $782,394, respectively, as compared to 2003, on the strength of higher oil and gas prices and lower operating expenses. The figures for the 2003 period earnings were also 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 Victoria Petroleum stock.

The Company's oil and gas revenues for the three months ended March 31, 2004 were $343,183 compared to $326,821 during the same period of 2003, an increase of $16,362 or 5%. 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 quarters. The Company's revenues for the nine-month period ended March 31, 2004 were $1,082,630 as compared to $828,811 during the same period in 2003, an increase of $253,819, or 31%. The increase in revenues was primarily the result of higher oil and gas prices received during the period. Once again, production levels were not materially different between the two nine-month periods.

The Company's total expenses for the third quarter ended March 31, 2004 increased $13,318, or 4%, to $384,590 as compared to $371,272 a year ago. The increase in overall expenses is primarily due to higher lease operating, exploration, depreciation expenses offset by lower general and administrative expenses. For the nine months ended March 31, 2004, total expenses increased $74,678, or 6%, to $1,331,472 as compared to $1,256,794 a year ago. The increase in expenses was primarily due to higher lease operating, abandoned property, depreciation and exploration expenses offset by lower general and administrative and interest expense.

Exploration expenses for the quarter ended March 31, 2004 increased by $14,625 to $14,432 from a year ago. There was no exploration activity during the 2003 period. For the nine months ended March 31, 2004, exploration expenses increased $9,133, or 48%, to $28,355 versus $19,222 a year ago. The increase in exploration expenses reflects a higher level of exploration activities in the current year as the Company currently maintains and enhances its properties.

General and administrative costs for the three months ended March 31, 2004 decreased $14,089, or 9%, to $143,150 as compared to $157,239 for the same period a year ago. The Company's general and administrative expenses for the nine months ended March 31, 2004 decreased $82,232, or 14%, to $520,280 from $602,512. These decreases were primarily attributable to a decrease in rent and office expenses.

Interest expense and loan fees for the three-month period ended March 31, 2004 increased $2,220, or 16%, to $16,331 from $14,111 a year ago. The increase is attributable to higher average borrowings outstanding during the period. For the nine months ended March 31, 2004, interest expense decreased $42,058 or 45%, to $51,866 from $93,924 a year ago. This decrease is attributable to lower average borrowings outstanding during the three-month period.

During the quarter, Barry D. Lasker, the Company's President and CEO, assigned the $200,000 Lasker Loan to Samson Exploration N.L. (a related party) and Mr. Lasker was paid off in full. The terms and conditions of the Samson loan are a continuance of the terms and conditions of the Lasker loan, except for the deletion of a provision providing for acceleration upon termination of Mr. Lasker's employment by the Company.

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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

At the end of the period reported on in 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 all material respects, with respect to the recording, processing, summarizing and reporting, within the time periods specified in the SEC's rules and forms, of information required to be disclosed by the Company in the reports the Company files or submits under the Exchange Act.

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 the evaluation described above.

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
Exhibit No. Description

10.1	Amendment to Revolving Credit Loan Agreement with Barry D. Laker dated February 24, 2004.
10.2	Assignment of Mortgage from Barry D. Lasker to Samson Exploration N.L. dated February 24, 2004.
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

1. A report on Form 8-K under Item 12 dated February 12, 2004 was filed with the Commission on February 13, 2004.

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 13, 2004

/S/BARRY D. LASKER
Barry D. Lasker, President, Chief Executive Officer, Principal Financial Officer and Director

EXHIBIT 31

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 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and I have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the small business issuer's internal controls over financial reporting that occurred during the small business issuer's third fiscal quarter that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and

5. I have disclosed, based on my most recent evaluation of internal control over financing reporting, to the small business issuer's auditors and the audit committee of small business issuer's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: May 13, 2004

/S/BARRY D. LASKER

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

EXHIBIT 32

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Kestrel Energy, Inc. (the "Company") on Form 10-QSB for the fiscal quarter ended March 31, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certifies, pursuant to 18 U.S.C. ss.1350, aS adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/S/BARRY D. LASKER

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

May 13, 2004