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KESTREL ENERGY INC  
Form 10QSB  
February 19, 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 DECEMBER 31, 2002  
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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.)

999 18TH STREET, SUITE 2490, DENVER, CO

80202

-----  
(Address of principal executive offices)

-----  
(Zip Code)

(303) 295-0344

-----  
(Registrant's telephone number, including area code)

Check whether the (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 December 31, 2002:  
9,115,200  
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KESTREL ENERGY, INC.

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### PART I. FINANCIAL INFORMATION

#### ITEM 1. Financial Statements

KESTREL ENERGY, INC.

BALANCE SHEETS AS OF DECEMBER 31, 2002 AND JUNE 30, 2002

(Unaudited)

	December 31, 2002	June 30, 2002
ASSETS		
-----	-----	-----
CURRENT ASSETS:		

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Cash and cash equivalents	\$ 59,993	\$ 56,548
Accounts receivable	170,595	209,016
Other assets	1,118	1,268
Investment in related party	254,250	356,125
	-----	-----
Total current assets	485,956	622,957
	-----	-----
<b>PROPERTY AND EQUIPMENT, AT COST:</b>		
Oil and gas properties, successful efforts method of accounting:		
Unproved	216,349	215,892
Proved	10,804,439	11,062,848
Pipeline and facilities	807,851	807,851
Furniture and equipment	111,095	135,387
	-----	-----
	11,939,734	12,221,978
Accumulated depreciation and depletion	(8,616,068)	(8,880,924)
	-----	-----
Net property and equipment	3,323,666	3,341,054
	-----	-----
	\$ 3,809,622	\$ 3,964,011
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Line of credit, bank	\$ 0	\$ 516,000
Loan from related party	33,131	58,369
Note payable-other	500,000	-
Accounts payable-trade	390,607	242,207
Accrued liabilities	186,369	81,268
	-----	-----
Total current liabilities	1,110,107	897,844
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred Stock, \$1 par value; 1,000,000 shares authorized, none issued	-	-
Common Stock, no par value; 20,000,000 shares authorized, 9,115,200 issued and outstanding at December 31, 2002 and June 30, 2002, respectively	20,043,907	20,043,907
Accumulated other comprehensive (loss)	(476,218)	(523,358)
Accumulated (deficit)	(16,868,174)	(16,454,382)
	-----	-----
Total stockholders' equity	2,699,515	3,066,167
	-----	-----
	\$ 3,809,622	\$ 3,964,011
	=====	=====

See accompanying notes to financial statements.

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STATEMENTS OF OPERATIONS FOR THE THREE MONTHS AND SIX MONTHS ENDED  
DECEMBER 31, 2002 AND 2001  
(Unaudited)

	Three months ended December 31,		Six mon Dece
	2002	2001	2002
<b>REVENUE:</b>			
Oil and gas sales	\$ 249,659	\$ 214,219	\$ 501,990
<b>COSTS AND EXPENSES:</b>			
Lease operating Expenses	160,316	169,698	271,520
Dry holes, abandoned and impaired properties	-	1,492	-
Exploration expenses	3,893	67,632	19,415
Depreciation and depletion	30,543	59,208	69,501
General and administrative	210,684	197,604	445,273
Interest / loan expense	64,539	25,234	79,813
TOTAL COSTS AND EXPENSES	469,975	520,868	885,522
<b>OTHER INCOME (EXPENSE):</b>			
Gain (loss) on sale of property and equipment	1,852	-	21,869
Gain(loss) on sale of available-for-sale securities	-	(226,520)	(92,774)
Interest	-	16	4,010
Other, net	14,834	18,663	36,635
	16,686	(207,841)	(30,260)
NET LOSS	\$ (203,630)	\$ (514,490)	\$ (413,792)
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>			
Unrealized gain (loss) from available-for-sale securities	(17,250)	-	47,140
Comprehensive loss	(220,880)	(514,490)	(366,652)
Net Loss Per Common Share	\$ (0.02)	\$ (0.07)	\$ (0.05)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	9,115,200	7,700,200	9,115,200

See accompanying notes to financial statements.

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KESTREL ENERGY, INC.

STATEMENTS OF CASH FLOWS FOR THE SIX MONTHS ENDED DECEMBER 31, 2002 AND 2001

(Unaudited)

	2002	2001
	-----	-----
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (413,792)	\$ (754,357)
Adjustments to reconcile net loss to net cash used in operating activities:		
Dry holes, abandoned and impaired properties	-	2,050
(Gain) loss on disposal of property	(21,869)	-
(Gain) loss on sale of available-for-sale securities	92,774	220,531
Depreciation and depletion	69,501	117,775
(Increase) decrease in accounts receivable	38,421	124,168
(Increase) decrease in due from related party	-	(6,003)
(Increase) decrease in other current assets	150	-
Increase (decrease) in accounts payable, trade	148,400	203,769
Increase (decrease) in accounts payable, related party	(25,238)	(26,397)
Increase (decrease) in accrued liabilities	34,224	(26,629)
Noncash interest / fee expense	73,537	-
	-----	-----
Net cash (used in) provided by operating activities	(3,892)	(145,093)
	-----	-----
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures/acquisition of properties	(52,921)	(75,096)
Proceeds from sale of securities	56,241	360,921
Proceeds from sale of property	20,017	-
	-----	-----
Net cash (used in) provided by investing activities	23,337	285,825
	-----	-----
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Advance from related party	-	350,000
Proceeds from issuance of debt	500,000	-
Repayments of borrowings	(516,000)	(526,000)
	-----	-----
Net cash provided by (used in) financing activities	(16,000)	(176,000)
	-----	-----
Net increase (decrease) in cash and cash equivalents	3,445	(35,268)
Cash and cash equivalents at the beginning of the period	56,548	119,025
	-----	-----
Cash and cash equivalents at the end of the period	\$ 59,993	\$ 83,757
	=====	=====
Cash paid for interest	\$ 6,276	\$ 76,618
	=====	=====

SELECTED NON CASH ACTIVITIES:

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Unrealized gain (loss) on available-for sale securities	(17,250)	-
	=====	=====

See accompanying notes to financial statements.

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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 December 31, 2002, 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. Investment in Related Party

The investment in Victoria Petroleum, NL ("VP") Common Stock is classified as available-for-sale. Net unrealized gains and losses on the investment are recorded to Other Comprehensive Income or Loss. At December 31, 2002, the unrealized loss on the investment was \$476,218. As of June 30, 2002, there was an unrealized loss on the investment of \$523,358. The Company sold 5,100,000 shares in August 2002, which resulted in a loss on sale of \$92,774. Proceeds of \$56,241 were received on the sale. As of December, 2002, the Company owned 25,000,000 shares of VP, which secure the loan with Samson Exploration N.L.

3. Line of Credit

On February 21, 2000, the Company entered into a Line of Credit agreement with Wells Fargo Bank West N.A., which provided the Company a borrowing base of \$600,000 with interest at Wells Fargo prime rate plus 2.5%. On September 27, 2000, the Company and Wells Fargo amended the Line of Credit Agreement to provide the Company a borrowing base of \$2,000,000 and reduced the interest rate to 1.5% over prime. In May 2001, the Company restructured its line of credit agreement with Wells Fargo. Under the prior terms the Company had a borrowing base of \$2,000,000 with interest paid monthly. The new agreement lowered the borrowing base to \$1,400,000 and required the Company to reduce the principal balance on the line of credit to \$1,400,000 by October 31, 2001 with interest on the outstanding balance paid monthly. The Company reduced the outstanding balance to \$1,396,000 by October 31, 2001. The Company finalized the restructuring of the line of credit with Wells Fargo in November 2001, which called for principal payments of \$1,340,000 by October 31, 2002. On August 8, 2002, the Company repaid Wells Fargo in full including all accrued interest and fees. The line of credit was secured by deeds of trust on various oil and gas producing properties held by us. On August 6, 2002 the Company entered

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into a loan agreement with Samson Exploration N.L. and borrowed \$500,000, pursuant to a promissory note. Under the terms of the agreement the Company is required to pay interest at 10% per annum and a financing fee of 10% of the borrowed funds. The proceeds from the loan were used to retire and satisfy the outstanding debt to Wells Fargo. On February 4, 2003, the Company repaid Samson Exploration 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 Victoria Petroleum stock. On January 24, 2002 the Company entered into a promissory agreement with R&M Oil and Gas LTD and borrowed \$400,000. Under the terms of the agreement the note is due on January 31, 2005 and the Company is required to pay interest at 12.5% per annum. The proceeds from the loan were used to retire and satisfy the outstanding debt to Samson Exploration and reduce the Company's accounts payable position.

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

### LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2002, the Company had a working capital deficit of \$624,151. This compares to the Company's working capital deficit of \$274,887 as of June 30, 2002. The increase in working capital deficit of \$349,264 was largely attributable to a decrease in value of available for sale securities of \$101,875, a decrease in trade accounts payable of \$148,400. In order for the Company to fund its working capital deficit, steps could include further sales of existing non-core properties, sale of shares of the Company's common stock, and further reductions of general and administrative expenses.

Net cash used in operating activities was \$3,892 for the six months ended December 31, 2002, a decrease of \$141,201 over cash used by operations of \$145,093 for the same period in 2001. Accounts receivable decreased \$38,421, or 18%, to \$170,595 during the period as compared to a decrease of \$124,168 a year ago. The decrease in accounts receivable was primarily attributable to lower oil and gas revenues as a result of lower production levels due to the sale of several non-core properties during the year. Accounts payable increased \$148,400, or 61%, to \$390,607 during the period versus an increase of \$203,769, or 168%, during the same period a year ago. The increase in payables reflects the Company's liquidity problems as a result of lower oil and gas prices during the year and its requirement to pay down debt levels. Accrued liabilities increased \$34,224, or 80%, to \$77,151 versus a decrease of \$26,628 in 2001. Accounts payable to a related party decreased \$25,239, or 100%, as the Company, through overhead charges, repaid advances from an affiliated Company. The Company, as a result of these overhead charges, now has a loan to a related party of \$33,131. Pursuant to this arrangement, the Company has billed the related party approximately \$13,950 per quarter for overhead and personnel.

Net cash provided by investing activities was \$23,337 for the six months ended December 31, 2002, versus cash provided of \$285,825 for the same period in 2001. The decrease of \$262,488 was primarily due to lower sales of securities of Victoria Petroleum, NL Common Stock during the six month period. The Company generated only \$56,241 from these sales this period versus \$360,921 during the same period last year. Gain on disposal of property increased \$20,017, or 100%, during the period. There was no gain or loss on the disposal of property for the 6 month period ended September 30, 2001.

Cash used in financing activities totaled \$16,000 for the six months ended December 31, 2002 versus cash used of \$176,000 a year ago. The Company made

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\$516,000 in principal payments to Wells Fargo Bank to satisfy the debt in full. Additionally, the Company reduced its debt to a related party by \$25,238 as a result of administrative expense charged to them. On August 6, 2002, the Company entered into a promissory agreement with Samson Exploration N.L. and borrowed \$500,000. Under the terms of the agreement the Company was required to pay interest at 10% per annum and a financing fee of 10% of the borrowed funds. The duration of the loan was 120 days and was due on December 4, 2002. The proceeds from the loan were used to retire and satisfy the outstanding debt to Wells Fargo. By mutual agreement the loan from Samson Exploration was extended to January 24, 2003. On February 4, 2003, the Company repaid Samson Exploration in full including all accrued interest and fees, with \$327,143.15 in cash and the Company's remaining 25,000,000 shares of Victoria Petroleum stock. On January 24, 2002, the Company entered into a promissory agreement with R&M Oil and Gas, LTD, a limited partnership in which one of the Company's directors, Timothy L. Hoops, indirectly holds a 60.3% interest, and borrowed \$400,000. Under the terms of the agreement the Company is required to pay interest at 12.5% per annum. The proceeds from the loan were used to retire and satisfy the outstanding debt to Samson Exploration and reduce the accounts payable position.

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### RESULTS OF OPERATIONS

The Company reported a loss of \$203,630, or 2 cents per share, for the three month period ended December 31, 2002. This compares with a loss of \$514,490, or 7 cents per share, for the same period a year ago. The lower loss in the current period is the result of slightly higher oil and gas revenues, lower operating expenses, lower exploration expenditures from year ago levels and a decrease in the loss on the sale of available securities of \$226,520 incurred during the same period a year ago.

The Company's revenues for the three months ended December 31, 2002 were \$249,659 compared to \$214,219 during the same period of 2001, an increase of \$35,410, or 17%. The increase in revenues was a result of higher oil and gas revenues offset by slightly lower production levels.

The Company's total revenues for the six month period ended December 31, 2002 were \$501,990 as compared to \$567,712 during the same period in 2001, a decrease of \$65,722, or 12%.

The Company's total expenses for the second quarter ended December 31, 2002 decreased \$50,893, or 10%, to \$469,975 as compared to \$520,868 a year ago. The decrease in overall expenses this quarter is primarily due to lower lease operating, exploration and DD&A expenses, and higher loan fees offset by higher oil and gas revenues. Production and operating expenses for the three month period decreased \$9382, or 6%, to \$160,316 versus \$169,698 for the same period a year ago. The decrease in operating expenses for the period was related to the previous sale of several high operating cost properties and a reduction in operating expenses at the Pierce water-flood project in Wyoming.

Total expenses for the six months ended December 31, 2002 decreased \$280,618, or 24%, to \$885,522 versus \$1,166,140 a year ago. The decrease in overall expenses is a result of lower exploration, expense and depreciation and depletion offset by higher interest expense and financing fees.

No dry holes, abandoned and impaired properties expense was recorded for the three months or six months ended December 31, 2002.

Exploration expenses for the quarter ended December 31, 2002 decreased \$63,739

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or 94%, to \$3,893 from \$67,632 a year ago.

For the six months ended December 31, 2002, exploration expenses decreased \$94,749, or 83%, to \$19,415 versus \$114,164 a year ago. The decrease in costs incurred for the quarter reflects the Company's commitment to pay down debt and minimize the accounts payables position.

General and administrative costs for the three months ended December 31, 2002 increased \$13,080 or 7%, to \$210,684 as compared to \$197,604 for the same period a year ago. The increase in expenses was largely attributable to an increase in NASDAQ and registration fees of approximately \$15,000. The Company remains committed to reducing General and Administrative costs as much as possible.

The Company's general and administrative expenses for the six months ended December 31, 2002 decreased \$5,032, or 1%, to \$445,273 from \$450,305.

Interest expense and fees increased \$39,305, or 155%, to \$64,539 from \$25,234 a year ago. This increase is to lower interest charges offset by the addition of loan fees.

For the six months ended December 31, 2002, interest expense and fees increased \$16,019 or 25% to \$79,813 from \$63,794 a year ago. The increase is attributable to lower interest charges offset by an increase in loan fees.

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### 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  
At the Company's annual meeting of shareholders on

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December 5, 2002, in Denver, Colorado, the Company's shareholders elected Barry D. Lasker, Timothy L. Hoops, Robert J. Pett, Kenneth W. Nickerson, John T. Kopcheff, Mark A. E. Syropoulo and Neil T. MacLachlan to the Company's Board of Directors. The shareholders also approved and ratified the selection of Wheeler Wasoff, P.C. as the Company's independent certified public accountants and auditors for the year ending June 30, 2003, and an amendment to the Company's stock option plan to extend the term of the plan for an additional ten years.

There were 9,115,200 shares of the Company's Common Stock issued and outstanding, of which 9,115,200 were entitled to vote at the meeting. Of that number, 4,603,538 were present in person or by proxy at the meeting. With respect to the election of directors, the votes were as follows: Mr. Lasker - 4,595,066 in favor, 8,472 withheld; Mr. Hoops - 4,595,066 in favor, 8,472 withheld; Mr. Pett - 4,595,066 in favor, 8,472 withheld; Mr. Kopcheff - 4,595,066 in favor, 8,472 withheld; Mr. Nickerson - 4,595,166 in favor, 8,372 withheld; Mr. Syropoulo - 4,595,066 in favor, 8,472 withheld; and Mr. MacLachlan - 4,595,066 in favor, 8,472 withheld. The selection of Wheeler Wasoff, P.C. received a vote of 4,597,113 shares for, 3,290 against and 3,135 abstaining. The amendment to the stock option plan was approved, with 4,544,140 shares for, 54,147 against and 5,251 abstaining. Abstentions and broker non-votes were counted for purposes of establishing a quorum only. Only those votes cast for the election of directors and the other proposals were counted as voted in favor or affirmative votes

- ITEM 5. OTHER INFORMATION  
Not applicable
- ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K  
(a) Exhibits

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- 10.1 Stock Option Plan as of December 5, 2002  
10.2 Loan Agreement with R&M Oil and Gas, Ltd.  
dated January 24, 2003  
99.1 Certification of Chief Executive Officer  
and Principal Financial Officer
- (b) Reports on Form 8-K  
A report on Form 8-K dated December 6, 2002 under  
Item 9 was filed with the Commission on December  
7, 2002.

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### 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.

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(Registrant)

Date: FEBRUARY 19, 2003  
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/S/BARRY D. LASKER  
-----

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

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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

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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: February 19, 2003

/S/BARRY D. LASKER

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