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KESTREL ENERGY INC
Form 10-Q
November 14, 2001

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

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

For the period ended SEPTEMBER 30, 2001

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) | |

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,
2001: 7,700,200

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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 SEPTEMBER 30, 2001 AND JUNE 30, 2001

(Unaudited)

| ASSETS | September 30, 2001 | June 30, 2001 |
|--|-----------------------|------------------|
| ----- | ----- | ----- |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 102,737 | \$ 119,025 |
| Accounts receivable | 222,671 | 278,834 |
| Other assets | 5,957 | 5,957 |
| | ----- | ----- |
| Total current assets | 331,365 | 403,816 |
| | ----- | ----- |
| PROPERTY AND EQUIPMENT, AT COST: | | |
| Oil and gas properties, successful efforts method of accounting: | | |
| Unproved | 217,384 | 217,941 |
| Proved | 12,458,552 | 12,398,775 |
| Pipeline and facilities | 807,851 | 807,851 |
| Furniture and equipment | 145,176 | 143,724 |
| | ----- | ----- |
| | 13,628,963 | 13,568,291 |
| Accumulated depreciation and depletion | (3,249,552) | (3,190,983) |
| | ----- | ----- |
| Net property and equipment | 10,379,411 | 10,377,308 |
| | ----- | ----- |
| Investment in related party | 1,250,316 | 2,130,178 |
| | ----- | ----- |
| | \$ 11,961,092 | \$ 12,911,302 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable: | | |
| Trade | \$ 294,396 | \$ 121,464 |
| Related party | 10,197 | 26,397 |
| Accrued liabilities | 100,641 | 124,808 |
| Line of credit, bank | 1,455,000 | 1,882,000 |
| Advance from related party | 350,000 | - |
| | ----- | ----- |
| Total current liabilities | 2,210,234 | 2,154,669 |
| | ----- | ----- |
| STOCKHOLDERS' EQUITY: | | |
| Preferred Stock, \$1 par value; 1,000,000 shares authorized, none issued | - | - |
| Common Stock, no par value; 20,000,000 shares authorized, | | |

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| | | |
|---|---------------|---------------|
| 7,700,200 issued and outstanding at September 30, 2001 and June 30, 2001 | 19,073,023 | 19,073,023 |
| Accumulated deficit | (8,582,688) | (8,342,821) |
| Accumulated other comprehensive (loss) income | (739,477) | 26,431 |
| | ----- | ----- |
| Total stockholders' equity | 9,570,858 | 10,756,633 |
| | ----- | ----- |
| | \$ 11,961,092 | \$ 12,911,302 |
| | ===== | ===== |

See accompanying notes to financial statements.

KESTREL ENERGY, INC. STATEMENTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000 (Unaudited)

| | 2000 | 2001 |
|---|--------------|--------------|
| | ----- | ----- |
| REVENUE: | | |
| Oil and gas sales | \$ 353,493 | \$ 352,680 |
| Interest | 2,054 | 2,308 |
| Other income | 43,869 | 14,572 |
| Gain on sale of available-for-sale securities | 5,989 | - |
| | ----- | ----- |
| TOTAL REVENUES | 405,405 | 369,560 |
| | ----- | ----- |
| COSTS AND EXPENSES: | | |
| Production and operating expenses | 221,195 | 122,041 |
| Dry holes, abandoned and impaired properties | 27,717 | - |
| Exploration expenses | 46,532 | 27,490 |
| Depreciation and depletion | 58,567 | 31,236 |
| General and administrative | 252,701 | 249,028 |
| Interest expense | 38,560 | 8,292 |
| | ----- | ----- |
| TOTAL COSTS AND EXPENSES | 645,272 | 438,087 |
| | ----- | ----- |
| NET LOSS | (239,867) | (68,527) |
| Other comprehensive loss - unrealized loss from available-for-sale securities | (739,477) | (514,000) |
| | ----- | ----- |
| Comprehensive loss | \$ (979,344) | \$ (582,527) |
| | ===== | ===== |
| NET LOSS PER COMMON SHARE | \$ (0.03) | \$ (0.01) |
| | ===== | ===== |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING | 7,700,200 | 7,680,000 |
| | ===== | ===== |

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See accompanying notes to financial statements.

KESTREL ENERGY, INC.
STATEMENTS OF CASH FLOWS FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2001 AND 2000
(Unaudited)

| | 2000 | 2001 |
|---|--------------|-------------|
| | ----- | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ (239,867) | \$ (68,527) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Dry holes, abandoned and impaired properties | 557 | - |
| Gain on sale of available for sale securities | (5,989) | - |
| Depreciation and depletion | 58,567 | 31,236 |
| Non cash compensation expense | - | 3,338 |
| (Increase) decrease in accounts receivable relating to operations | 56,163 | (1,278) |
| (Increase) decrease in due from related party | - | 524 |
| (Increase) decrease in other current assets | - | 5,179 |
| Increase (decrease) in accounts payable, trade | 172,932 | (865,084) |
| Increase (decrease) in accounts payable, related party | (16,200) | 42,609 |
| Increase (decrease) in accrued liabilities | (24,167) | 21,917 |
| | ----- | ----- |
| Net cash provided by (used in) operating activities | 1,996 | (830,086) |
| | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures/acquisition of properties | (61,229) | (131,655) |
| Proceeds from sale of securities | 119,945 | - |
| | ----- | ----- |
| Net cash provided by (used in) investing activities | 58,716 | (131,655) |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Advance from related party | 350,000 | - |
| Net borrowings (payments) on | | |

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| | | |
|---|------------|------------|
| line of credit | (427,000) | 600,000 |
| | ----- | ----- |
| Net cash provided by (used in) financing activities | (77,000) | 600,000 |
| | ----- | ----- |
| Net decrease in cash and cash equivalents | (16,288) | (361,741) |
| Cash and cash equivalents at the beginning of the period | 119,025 | 502,034 |
| | ----- | ----- |
| Cash and cash equivalents at the end of the period | \$ 102,737 | \$ 140,293 |
| | ===== | ===== |

See accompanying notes to financial statements.

KESTREL ENERGY, INC.
STATEMENTS OF CASH FLOWS FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2001 AND 2000, CONTINUED
(Unaudited)

| | | |
|---|--------------|--------------|
| | 2000 | 2001 |
| | ----- | ----- |
| SELECTED NON CASH ACTIVITIES: | | |
| Total property acquisitions | \$ - | \$ 394,155 |
| Accounts payable and accrued expenses used to acquire property | - | (262,500) |
| | ----- | ----- |
| Net cash used to acquire property | \$ - | \$ 131,655 |
| | ===== | ===== |
| Cash paid for interest | \$ 42,143 | \$ 8,292 |
| | ===== | ===== |
| Unrealized loss on available-for-sale securities | \$ (739,477) | \$ (514,000) |
| | ===== | ===== |

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 consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal

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year ended June 30, 2001.

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, 2001, 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 September 30, 2001, the unrealized loss on the investment was \$739,477. As of June 30, 2001, there was an unrealized gain on the investment of \$26,431. The Company sold 3,900,000 shares in July 2001 which resulted in cash proceeds of \$119,943 and a gain on sale of \$5,989. As of September 30, 2001, the Company owns 68,100,000 shares of VP.

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. On May 31, 2001, Wells Fargo reduced the borrowing base to \$1,400,000. As a result of the reduction to the borrowing base, the Company was required to make scheduled principal payments to reduce the amount outstanding to \$1,400,000 by October 31, 2001, the maturity date of the line of credit. The line of credit is secured by Deeds of Trust on various oil and gas producing properties held by the Company. As of September 30, 2001, \$1,455,000 was outstanding on the line of credit. The Company reduced the outstanding balance to \$1,396,000 as of October 31, 2001. Wells Fargo has granted the Company an extension to November 30, 2001 to restructure the line of credit. The Company and Wells Fargo are currently determining the payment schedule and expect to finalize the restructuring by November 30, 2001.

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

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2001, the Company had a working capital deficit of \$1,878,869. This compares to the Company's working capital deficit of \$1,750,853 as of June 30, 2001. The increase in working capital deficit of \$128,016 was a result of the loss from operations for the first quarter ended September 30, 2001. The Company's revenues from oil and gas sales declined sharply from fiscal fourth quarter 2001 as both oil and gas prices declined. The Company was required to pay Wells Fargo Bank \$427,000 in principal payments on the line of credit during the quarter, which the Company funded in part by borrowing \$350,000 from Victoria Petroleum, NL, an affiliated company ("VP"). In order for the Company to fund its working capital deficit, additional shares of VP Common Stock held by the Company will be liquidated as possible on an on-going basis. Additional steps could include a sale of existing properties, sale of

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shares of the Company's common stock, and further reductions of general and administrative expenses.

Net cash provided by operating activities was \$1,996 for the three months ended September 30, 2001, an increase of \$832,082 over cash used by operations of \$830,086 for the same period in 2000. Operating cash flow increased due to an increase in accounts payable despite an operating loss for the period. Accounts receivable decreased \$56,163, or 20%, to \$222,671 during the period as compared to an increase of \$1,278 a year ago. The decrease in accounts receivable was attributable to lower oil and gas revenues as a result of lower oil and gas prices received during the quarter. Accounts payable increased \$172,932, or 142%, to \$294,396 during the period versus a decrease of \$865,084, or 61%, during the same period a year ago. The increase in payables reflects the Company's liquidity problems during this period of lower oil and gas prices. Accrued liabilities decreased \$24,167, or 19%, to \$100,641 versus an increase of \$21,917 (net of \$262,500 used to acquire property) in 2000. Accounts payable related party decreased \$16,200, or 61%, to \$10,197. The decrease reflects the overhead charged to the related party for office space and personnel during the period.

Net cash provided from investing activities was \$58,716 for the quarter ended September 30, 2001, versus cash used of \$131,655 for the same period in 2000. The increase resulted from the sale of 3,900,000 shares of VP Common Stock during the quarter, which generated \$119,945 in proceeds. The Company recognized a gain of \$5,989 on the sale. Capital expenditures for the period ended September 30, 2001 of \$61,229 included \$1,450 for office equipment, \$3,300 for equipment on the Greens Canyon 29-2 well in Wyoming, approximately \$34,000 for continued development of various coalbed methane wells in Wyoming, and \$22,479 for well equipment on the Pierce Unit in Wyoming.

Cash used by financing activities totaled \$77,000 for the three months ended September 30, 2001 versus cash provided of \$600,000 a year ago. The Company made \$427,000 in principal payments to Wells Fargo Bank pursuant to the line of credit agreement of May 2001. Due to the reduction in oil and gas revenues during the first quarter of fiscal 2002 from levels realized in the third and fourth quarters of fiscal 2001, the Company was advanced \$350,000 from Victoria Petroleum, NL, an affiliated company ("VP"), to provide additional working capital. The Company and VP do not have a formal agreement currently in place regarding this advance. The Company anticipates making interest only payments on the advance at a market rate of interest until such time as the Company can increase its cash flow to repay the advances. The Company and VP are currently discussing a formalization of the terms of the advance repayment.

RESULTS OF OPERATIONS

FIRST QUARTER RESULTS

The Company reported a loss of \$239,867, or 3 cents per share, for the three month period ended September 30, 2001. This compares with a loss of \$68,527, or 1 cent per share, for the same period a year ago. The increased loss in the current period is a result of higher overall expenses versus a year ago, despite slightly higher total revenues.

The Company's revenues for the three months ended September 30, 2001 were \$405,405 compared to \$369,560 during the same period of 2000, an increase of \$35,845, or 10%. Revenues from oil and gas sales were \$353,493 for the quarter ended September 30, 2001, an increase of \$813 as compared to \$352,680 for the same period in 2000. The increase in oil and gas revenues is attributable to higher gas volumes compared to a year ago despite slightly lower oil and gas prices. Other income increased

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\$29,297, or 201%, to \$43,869 versus \$14,572 for the same period a year ago. The increase was attributed to the sale of tubing on the McEntire lease in Kansas for \$24,900 and higher overhead charges to a related party for use of the Company's office space and personnel. The Company recorded a \$5,989 gain on sale of securities as result of the sale of 3,900,000 shares of VP Common Stock in July 2001. See Footnote 2 to the financial statements.

The Company's total expenses increased \$207,185, or 47%, to \$645,272 as compared to \$438,087 a year ago. The increase in overall expenses is attributable to higher lease operating expense, abandonment costs, depletion, and exploration expense as discussed below.

Production and operating expenses increased \$99,154, or 81%, to \$221,195 versus \$122,041 for the same period a year ago. The increase in production and operating expenses was primarily due to higher lease operating expenses on various wells including the Burditt, Cab Hughes, Pierce Unit, Grady Unit, Kaye Unit, Wagenson Waterflood, and the Turner 1-23 and 3-14 wells. The wells listed above had minor lease operating expense in the year ago period for various reasons. The Pierce and Kaye Units were shut in a year ago. The Turner wells and the Wagenson Waterflood were not in existence a year ago. Several other wells also incurred higher lease operating expenses during the first quarter but those increases were not individually material. The wells listed above accounted for approximately \$93,000 of the increase versus September 2000.

Dry holes, abandoned and impaired properties expense was \$27,717 for the three months ended September 30, 2001. The Company incurred \$27,717 of abandonment expense on the McEntire lease in Kansas. These costs were offset by the sale of tubing on the leases of \$24,900 as noted above.

Exploration expenses increased \$19,042, or 69%, to \$46,532 from \$27,490 a year ago. The increase is attributable to higher engineering expenses and higher geological and geophysical expenses.

General and administrative costs increased \$3,673, or 1%, to \$252,701 as compared to \$249,028 for the same period a year ago. The increase in expenses is not attributable to any particular expense item.

Interest expense increased \$30,268 to \$38,560 from \$8,292 a year ago. The increase in interest expense is due to the interest paid on the outstanding balance of the Company's line of credit.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.

Until fiscal 2000, the Company did not invest in or hold market risk sensitive or interest rate sensitive instruments and the only currency exchange rate risk borne by the Company stemmed from the Company's obligations to fund its international drilling in Australian dollars. The Company no longer has currency exchange risk relating to its own operations, as it no longer participates in international drilling. As of September 30, 2001, the Company owns 68,100,000 shares of Victoria Petroleum, NL ("VP") Common Stock. The investment in 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. The VP shares are traded publicly on the Australian Stock Exchange and the price for which the Company could sell its VP shares, which are quoted in prices denominated in Australian dollars, could be higher or lower than the Company's cost. At September 30, 2001, the unrealized loss on the investment was \$739,447. The Common Stock of VP was trading for \$.036 cents per share in Australian dollars as of September 30, 2001. The Company applies the exchange rate between the U.S. dollar and Australian

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dollar as quoted in the Wall Street Journal. On September 30, 2001, the exchange rate in dollar terms was \$.51 which resulted in a U.S. dollar share price of \$.01836 cents per share.

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 - None
(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: November 14, 2001 /s/BARRY D. LASKER

Barry D. Lasker
President and Chief Executive
Officer

Date: November 14, 2001 /s/MARK A. BOATRIGHT

Mark A. Boatright
Vice President - Finance,
Principal Financial and Accounting
Officer