

Citadel Exploration, Inc.  
Form 10-Q  
May 20, 2015

**UNITED STATES**

**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 quarterly period ended March 31, 2015**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission file number 000-54639**

**CITADEL EXPLORATION, INC.**

(Exact name of registrant as specified in its charter)

**Nevada**

(State or other jurisdiction of incorporation or organization)

**27-1550482**

(I.R.S. Employer Identification No.)

**417 31<sup>st</sup> Street, Unit A**

**Newport Beach, CA 92663**

(Address of principal executive offices)

**(949) 612-8040**

(Registrant's telephone number, including area code)

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

Indicate by check mark 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.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer company	Smaller reporting company

(Do not check if a smaller reporting)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Common Stock, \$0.001 par value, outstanding on May 20, 2015 was 32,814,000 shares.

**CITADEL EXPLORATION, INC.**

**QUARTERLY PERIOD ENDED MARCH 31, 2015**

**Index to Report on Form 10-Q**

	<b>Page No.</b>
<b>PART I - FINANCIAL INFORMATION</b>	
Item 1. <u>Financial Statements</u>	3
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	18
Item 4. <u>Controls and Procedures</u>	19
<b>PART II - OTHER INFORMATION</b>	
Item 1. <u>Legal Proceedings</u>	20
Item 1A. <u>Risk Factors</u>	20
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	20
Item 3. <u>Defaults Upon Senior Securities</u>	21
Item 4. <u>Mine Safety Disclosures</u>	21
Item 5. <u>Other Information</u>	21
Item 6. <u>Exhibits</u>	22
Signature	23

[\(table of contents\)](#)**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements.****CITADEL EXPLORATION, INC. AND SUBSIDIARY  
(AN EXPLORATION STAGE COMPANY)  
CONSOLIDATED CONDENSED BALANCE SHEETS**

	March 31, 2015 (Unaudited)	December 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash	\$45,380	\$270,298
Other receivable	25,782	1,209
Prepaid expenses	21,598	35,886
Product inventory	4,881	4,881
Total current assets	97,641	312,274
Deposits	9,900	4,900
Restricted cash	45,000	45,000
Oil and gas properties	2,215,132	2,042,054
Fixed assets, net	22,092	25,927
Total assets	\$2,389,765	\$2,430,155
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$613,837	\$604,558
Contingent Liability	87,000	
Accrued interest payable	52,958	—
Notes payable, net	500,000	592,533
Derivative Liability		13,308
Total current liabilities	1,253,795	1,210,399
Asset retirement obligation	48,923	48,923
Production payment liability	300,000	300,000
Total liabilities	1,602,718	1,559,322
Stockholders' equity :		
Common stock, \$0.001 par value, 100,000,000 shares authorized, 32,814,000 and 31,389,000 shares issued and outstanding as of March 31, 2015 and December 31, 2014, respectively	32,814	31,389
Additional paid-in capital	4,948,815	4,673,497

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

Accumulated deficit	(4,194,581)	(3,836,303)
Subscription payable	—	2,250
Total stockholders' equity	787,048	870,833
Total liabilities and stockholders' equity	\$2,389,765	\$2,430,155

See Accompanying Notes to Consolidated Condensed Financial Statements.

(table of contents)

**CITADEL EXPLORATION, INC. AND SUBSIDIARY**  
**(AN EXPLORATION STAGE COMPANY)**  
**CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS**  
**(unaudited)**

	For the three months ended March 31,	
	2015	2014
Revenue	\$20,028	\$—
Operating expenses:		
Lease operating expense	11,658	27,882
Geological and geophysical expense	—	2,100
General and administrative	55,887	96,472
Depreciation, amortization and accretion	3,835	3,247
Professional fees	11,880	52,439
Executive compensation	162,088	119,482
Total operating expenses	245,348	301,622
Other expenses:		
Gain - other	—	8,316
Loss - Contingency	(87,000)	
Loss - on note payable settlement	(26,080 )	33,545
Interest expense	(19,877 )	(3,168 )
Total other expenses	(132,957 )	38,693
Net loss before provision for income taxes	(358,277 )	(262,929 )
Provision for income taxes	—	—
Net loss	\$(253,316 )	\$(262,929 )
Weighted average number of common shares outstanding - basic and diluted	36,629,833	29,714,000
Net loss per share - basic and diluted	\$(0.01 )	\$(0.01 )

See Accompanying Notes to Unaudited Consolidated Condensed Financial Statements.

(table of contents)

**CITADEL EXPLORATION, INC. AND SUBSIDIARY**  
**(AN EXPLORATION STAGE COMPANY)**  
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**  
**(unaudited)**

	For the three months ended March 31,	
	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$(358,277)	\$(262,929)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation, amortization and accretion	3,836	3,247
Amortization of debt discount	5,217	2,450
Gain on settlement of note payable	26,080	(33,545 )
Stock based compensation expense	37,498	37,498
Shares issued for consulting	—	114,338
Loss contingency	87,000	110,775
Gain - other		(8,316)
Changes in operating assets and liabilities:		
Decrease (increase) in other receivables	(24,575)	19,060
Decrease in prepaid expense	14,287	7,079
Increase in deposits	(5,000 )	—
Increase in accounts payable and accrued liabilities	9,277	(3,807 )
Increase in accrued interest payable	52,959	
Net cash used in operating activities	(151,698)	(128,488)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase oil and gas properties	(173,076)	(397,210)
Purchase of fixed assets	—	(18,273 )
Net cash used in investing activities	(173,076)	(415,375)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from sale of common stock, net of costs	107,836	(652 )
Proceeds from notes payable	—	500,000
Repayments for notes payable	(7,980)	(8,134 )
Net cash provided by financing activities	99,856	491,214
<b>NET CHANGE IN CASH</b>	<b>(224,918)</b>	<b>(52,649 )</b>
<b>CASH AT BEGINNING OF PERIOD</b>	<b>270,298</b>	<b>402,649</b>
<b>CASH AT END OF PERIOD</b>	<b>\$45,380</b>	<b>\$350,000</b>
<b>SUPPLEMENTAL INFORMATION</b>		
Interest Paid	\$435	\$429
Taxes Paid	\$—	\$—
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES</b>		
Financing of prepaid insurance	\$—	\$45,000
Issuance of common stock for settlement of notes payable and accrued interest	\$102,164	\$307,501

See Accompanying Notes to Consolidated Condensed Financial Statements.

-5-



(table of contents)

**CITADEL EXPLORATION, INC. AND SUBSIDIARY**

**(AN EXPLORATION STAGE COMPANY)**

**Notes to Consolidated Condensed Financial Statements**

**(Unaudited)**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of presentation

The interim financial statements included herein, presented in accordance with United States generally accepted accounting principles and stated in US dollars, have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these interim financial statements be read in conjunction with the financial statements of the Company for the year ended December 31, 2013 and notes thereto included in the Company's 10-K annual report and all amendments. The Company follows the same accounting policies in the preparation of interim reports.

Results of operations for the interim period are not indicative of annual results.

Principles of consolidation

The consolidated condensed financial statements include the accounts of Citadel Exploration, Inc. and Citadel Exploration, LLC. All significant intercompany balances and transactions have been eliminated. Citadel Exploration, Inc. and Citadel Exploration, LLC will be collectively referred herein to as the "Company".

Nature of operations

Currently, the Company is focused on the acquisition and development of oil and gas resources in California. The Company has not yet found oil and gas resources in commercially exploitable quantities and is engaged in exploring land in an effort to discover them. The Company has been in the exploration stage since its formation and has not

realized revenues from its planned principal operations.

#### Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ significantly from those estimates.

#### Fair value of financial instruments

The carrying value of the Company's financial instruments, including cash, due to shareholders/related parties and accounts and other payables approximate their fair values due to the immediate or short-term maturity of these instruments. It is management's opinion that the Company is not exposed to significant interest, price or credit risks arising from these financial instruments.

#### Earnings per share

The Company follows ASC Topic 260 to account for the earnings per share. Basic earnings per common share ("EPS") calculations are determined by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share calculations are determined by dividing net income by the weighted average number of common shares and dilutive common share equivalents outstanding. During periods when common stock equivalents, if any, are anti-dilutive they are not considered in the computation.

(table of contents)

**CITADEL EXPLORATION, INC. AND SUBSIDIARY**

**(AN EXPLORATION STAGE COMPANY)**

**Notes to Consolidated Condensed Financial Statements**

**(Unaudited)**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Recent pronouncements

The Company has evaluated the recent accounting pronouncements through May 2015 and believes that none of them will have a material effect on the company's financial statements.

**NOTE 2 – GOING CONCERN**

The accompanying consolidated condensed financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the recoverability of assets and the satisfaction of liabilities in the normal course of business. As noted above, the Company has just begun to generate revenue however this revenue is not enough to sustain the business without additional capital. Since its inception, the Company has been engaged substantially in financing activities and developing its business plan and incurring startup costs and expenses. As a result, the Company incurred accumulated net losses from Inception (November 6, 2006) through the period ended March 31, 2015 of (\$4,194,581). In addition, the Company's development activities since inception have been financially sustained through debt and equity financing.

The ability of the Company to continue as a going concern is dependent upon its ability to raise additional capital from the sale of common stock and, ultimately, the achievement of significant operating revenues. These consolidated condensed financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amounts and classification of liabilities that might result from this uncertainty.

**NOTE 3 – OIL AND GAS PROPERTIES**

The costs recorded in oil and gas properties as of March 31, 2015 and December 31, 2014 are as follows:

	2015	2014
Exploration	\$2,215,132	\$2,042,054

The following table reflects the net changes in capitalized exploratory well costs that have been capitalized for a period of one year or less since completion of drilling as of March 31, 2014:

Beginning balance at January 1, 2015 (excluding asset retirement obligation)	2015 \$1,993,305
Additions to capitalized exploratory well costs pending the determination of proved reserves	173,077
Asset retirement obligation	48,750
Ending balance at March 31, 2015	\$2,215,132

(table of contents)

**CITADEL EXPLORATION, INC. AND SUBSIDIARY**

**(AN EXPLORATION STAGE COMPANY)**

**Notes to Consolidated Condensed Financial Statements**

**(Unaudited)**

**NOTE 3 – OIL AND GAS PROPERTIES (CONTINUED)**

Project Indian

Project Indian is located in the Bitterwater sub-basin of the Salinas Basin, north of the giant San Ardo Field. Citadel currently owns a 100% working interest at Project Indian in July of 2014 Citadel ended its prior joint venture with Sojitz Energy Ventures. There is a 20% royalty on the property owned by Vintage Petroleum, a wholly owned subsidiary of Occidental Petroleum Inc. In November of 2014 Occidental Petroleum Inc. spun off its California assets into a new public company called California Resources Corporation, which is listed on the New York Stock Exchange under the ticker CRC. CRC is now the mineral owner at Project Indian.

In January of 2014, Citadel drilled and completed the first well at Project Indian, the Indian #1-15, and conducted a successful steam cycle in June of 2014. The Indian #1-15 then produced 3 to 7 barrels per day over several weeks before production halted because the well was shut-in by an order of the Superior Court of the State of California-County of Monterey entitled *Center for Biological Diversity v. San Benito County* Case no. M123956 (hereinafter the “Case”).

In the Case, the Center for Biological Diversity, a non-governmental entity, petitioned the Court over the approval of Project Indian by the County of San Benito on a unanimous, 5-0 vote. Specifically, it argued that Project Indian required an Environmental Impact Report and not a Mitigated Negative Declaration which was the standard of environmental due diligence required by the County before its unanimous approval of the Project. The Court approved the petition in a judgment entered on September 4, 2014, and ruled that Citadel was required to obtain an environmental impact report before commencing further at Project Indian .

Then, on November 4, 2014 Measure J was passed by a majority of participating, registered voters in the County of San Benito. Measure J bans hydraulic fracturing and other stimulation techniques defined as “high intensity petroleum operations” by the Measure, including cyclic steam injection. Citadel believes the passing of Measure J constitutes a regulatory taking of property and is preempted by the State of California. At this time there is no certainty that we will be able to develop the Indian Oil Field.

Per ASC 932, these wells qualify as exploratory wells and review of the capitalized costs incurred to prove up reserves must be evaluated in the period of one year after the completion of the drilling date.

### Yowlumne

In May 2013, we leased approximately 2,800 acres from AERA Energy, LLC (“Aera”). This acreage has been mapped using a combination of both 2D and 3D seismic, and is in close proximity to the Yowlumne oil field in Kern County, California. The Company is obligated to pay a 20% royalty to Aera. In August of 2013, the Company entered into an agreement to sell 55% of the interest in the Yowlumne lease, recouping approximately 85% of its cost, while retaining a 25% interest in the lease and operatorship. In July of 2014 the Company ended its joint venture with Sojitz Energy Ventures retaining Sojitz’s 55% interest in the Yowlumne lease, therefore increasing Citadel’s ownership to 75% in the Yowlumne lease.

Additionally, as part of this transaction, the Company retained 100% interest in the Yowlumne #2-26 well, and the 160 acres surrounding the well bore. The Yowlumne #2-26 was first drilled in 2008 under supervision of Citadel CEO, Armen Nahabedian, during his previous tenure with his family’s oil company. Although the well tested oil at that time, the well was left idle for 5 years as lease issues prevented operations on the well until the appropriate curative measures could be taken.

[\(table of contents\)](#)**CITADEL EXPLORATION, INC. AND SUBSIDIARY****(AN EXPLORATION STAGE COMPANY)****Notes to Consolidated Condensed Financial Statements****(Unaudited)****NOTE 3 – OIL AND GAS PROPERTIES (CONTINUED)**

In December of 2014, Citadel began a work-over on the Yowlumne #2-26 well including installation of a new pump in February of 2015. The well has been producing approximately 20- 25 barrels per day (32 degree API quality) since the beginning of March. Citadel is in the final stages of the CEQA process to permit two additional exploration wells on the Yowlumne acreage and expects to receive those drilling permits in the second quarter of 2015, with drilling to commence in the third quarter of 2015. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 15,000 feet. Citadel currently has a 75% working interest in these exploration prospects and is the operator.

**NOTE 4 – RESTRICTED CASH**

Restricted cash consists of two bonds totaling \$45,000. The bonds are required in the normal course of business in the oil and gas industry. The two bonds totaling \$45,000 were purchased in November 2013. The bonds will not be released until after the Indian #1-15 and the Yowlumne #2-26 wells are properly abandoned, and the property has been restored to its original condition.

**NOTE 5 – NOTES PAYABLE**

Notes payable consists of the following at:

	March 31, 2015	December 31, 2014
Two notes payable to investors, unsecured, 10% interest; due October 30, 2014	\$ 500,000	\$ 500,000
Promissory note to an entity; 10%	—	100,000

interest, due December 2015			
Debt discount for 25,000 shares issued relating to note payable	—	(1,930	)
Debt discount for derivative liability embedded in note payable	—	(13,308	)
	\$ 500,000	592,533	

During the quarter ended March 31, 2015, the Company settled the \$100,000 note payable with 681,100 shares valued at \$102,164. Interest expense on the note payable was \$2,164.

Interest expense for the quarter ended March 31, 2015 was \$19,877. Interest expense for the quarter ended March 31, 2014 was \$3,168. The \$500,000 of notes, were due on October 30, 2014 and are currently in default .



(table of contents)

**CITADEL EXPLORATION, INC. AND SUBSIDIARY**

**(AN EXPLORATION STAGE COMPANY)**

**Notes to Consolidated Condensed Financial Statements**

**(Unaudited)**

**NOTE 6 – STOCKHOLDERS’ EQUITY**

The Company is authorized to issue 100,000,000 shares of its \$0.001 par value common stock.

In January 2014, the Company issued 205,085 shares of common stock for services rendered and prepaid expenses with a value of \$114,338.

In January 2014, the Company issued 559,092 shares of common stock to settle three notes payable and accrued interest totaling \$306,849. The shares were recorded at fair value of \$273,304, resulting in a gain of \$33,545.

In March of 2014, the Company closed on a \$500,000 bridge loan from two individuals. These notes have a 180 day term and bear interest of 10%. Additionally investors received 500,000 warrants to purchase the Company’s stock at \$1.00 per share for a term of two years, valued at \$147,102 in total. In September of 2014, the maturity date of this bridge loan was extended by 30 days; in return the exercise price of the warrant was reduced to \$0.34 per share, with the original two year term remaining. Due to the change in the terms of the warrants, the Company recalculated the value of the warrants to be \$85,325. Accordingly, the Company recognized a gain on the extinguishment of \$73,573.

In August of 2014, investors owning warrants for the company’s stock, converted early at a reduced price. The first tranche of warrants equaled 500,000 shares at \$0.55, which were reduced to \$0.34 resulting in the issuance of 500,000 common stock shares for \$170,000 or \$0.34 per share. The second tranche of warrants equaled 100,000 warrants at \$1.00 per share. These warrants were exchanged for the issuance of 300,000 shares at \$0.34 for \$102,000 in cash.

On August 7, 2014 the Company issued 400,000 shares of common stock at a price for \$0.34 for legal, accounting and investor relation services.

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

At December 2014, the company was obligated to issue 25,000 shares of common stock in connection with a note payable. On the date the agreement was executed, the price per share of the Company's stock was \$0.09. As the shares have not been issued as of December 31, 2014, the Company recorded a stock payable with a value of \$2,250.

During the year ended December 31, 2014, the Company issued 875,000 shares of common stock valued at \$183,500 to various parties for accounting, legal, and marketing services.

In March of 2015, the Company approved the issuance of 1,400,000 common stock shares for the conversion of a \$100,000 promissory note, plus accrued interest of \$2,164 and an additional capital investment of \$107,835, all at \$0.15 per share.

In March of 2015, the Company issued 25,000 shares of common stock to settle the stock payable of \$2,250 recorded as of December 31, 2014.

[\(table of contents\)](#)**CITADEL EXPLORATION, INC. AND SUBSIDIARY****(AN EXPLORATION STAGE COMPANY)****Notes to Consolidated Condensed Financial Statements****(Unaudited)**

## NOTE 7 – STOCK OPTION PLAN

On September 1, 2012, the Board of Directors of the Company ratified, approved, and adopted a Stock Option Plan for the Company allowing for the grant of up to 10,000,000 shares of common stock or stock options to acquire common shares. In the event an optionee ceases to be employed by or to provide services to the Company for reasons other than cause, any Stock Option that is vested and held by such optionee may be exercisable within up to thirty days after the effective date that his position ceases. No Stock Option granted under the Stock Option Plan is transferable. Any Stock Option held by an optionee at the time of his death may be exercised by his estate within six months of his death or such longer period as the Board of Directors may determine.

As approved by the Board of Directors, on September 4, 2012, the Company granted 4,000,000 stock options to two officers of the Company at \$0.20 per share for terms of seven years. Of the total stock options, 1,000,000 vested immediately and the remaining vest equally over the next 3 years at the anniversary date of the employment agreements. The total fair value of these options at the date of grant was estimated to be \$599,974 and was determined using the Black-Scholes option pricing model with an expected life of 7 years, a risk free interest rate of 1.01%, a dividend yield of 0% and expected volatility of 254%. During the years ended December 31, 2014 and 2013, \$149,995 and \$113,888, respectively, was recorded as a stock based compensation expense.

On June 18, 2014 as approved by the Board of Directors, the Company granted 800,000 stock options to four members of the Board of Directors, which vested immediately, at \$0.55 per share for terms of seven years. The total fair value of these options at the date of grant was estimated to be \$264,495 and was determined using the Black-Scholes option pricing model with an expected life of 7 years, a risk free interest rate of 0.45%, dividend yield of 0%, and expected volatility of 235%. During the year ended December 31, 2014, \$264,494 was recorded as a stock based compensation expense.

The following is a summary of the status of all of the Company's stock options as of March 31, 2015 and changes during the period ended on that date:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)
Outstanding at January 1, 2015	4,800,000	\$ 0.26	4.71

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

Granted	—	\$ 0.00	—
Exercised	—	\$ 0.00	—
Cancelled	—	\$ 0.00	—
Outstanding at			
March 31, 2015	4,800,000	\$ 0.26	4.71
Exercisable at March 31, 2015	3,200,000	\$ 0.22	4.53

(table of contents)

**CITADEL EXPLORATION, INC. AND SUBSIDIARY**

**(AN EXPLORATION STAGE COMPANY)**

**Notes to Consolidated Condensed Financial Statements**

**(Unaudited)**

**NOTE 8 – WARRANTS**

On November 15, 2012, the Company granted 500,000 stock warrants to a lender at \$0.55 per share for terms of two years. The total fair value of these warrant at the date of grant was estimated to be \$217,330 and was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.28%, a dividend yield of 0% and expected volatility of 302%. During year ended December 31, 2012, \$132,813 was recorded as amortization of debt discount and included in interest expense. During year ended December 31, 2013, \$178,267 was recorded amortization of debt discount and included in interest expense.

In September 2013, we closed on a \$200,000 90-day bridge loan with two investors. The loans bear interest of 10%. Additionally each investor was granted 100,000 stock warrants to purchase stock at \$1.00 per share for a period of one year. The total fair value of these warrants at the date of grant was estimated to be \$56,283 and was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.1%, a dividend yield of 0% and expected volatility of 197%. An additional \$100,000 note payable with the same terms and warrants which were issued in October 2013 . The total fair value of these warrants at the date of grant was estimated to be \$37,467 and was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.1%, a dividend yield of 0% and expected volatility of 197%. During the year ended December 31, 2013, \$21,297 was recorded as amortization of debt discount and included in interest expense. During the year ended December 31, 2014, \$63,892 was recorded as amortization of debt discount and included in interest expense.

In March 2014, the Company closed on a \$500,000 180-day bridge loan with two investors. The loans bear interest of 10%. Additionally, the investors were granted a total of 500,000 stock warrants to purchase stock at \$1.00 per share for a period of two years valued at \$147,102. The total fair value of these warrant at the date of grant was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.45%, a dividend yield of 0% and expected volatility of 333%. In September of 2014, the maturity date of this bridge loan was extended by 30 days, in return the exercise price of the warrant was reduced to \$0.34 per share, with the original two year term remaining. Due to the change in the terms of the warrants, the Company recalculated the value of the warrants to be \$85,325. Accordingly, the Company recognized a gain on the extinguishment of \$73,573.

In September of 2014, the 500,000 warrants issued on November 15, 2012 and 100,000 warrants issued in September 2013 were exercised early at a reduced price of \$0.34 per share.

The following is a summary of the status of all of the Company's stock warrants as of December 31, 2014 and changes during the period ended on that date:

	Number of Warrants	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)
Outstanding at January 1, 2015	500,000	\$ 0.34	1.33
Granted	—	\$ —	—
Exercised	—	\$ —	—
Cancelled	—	\$ —	—
Outstanding at March 31, 2015	500,000	\$ 0.34	1.08
Exercisable at March 31, 2015	500,000	\$ 0.34	1.08

(table of contents)

**CITADEL EXPLORATION, INC. AND SUBSIDIARY**

**(AN EXPLORATION STAGE COMPANY)**

**Notes to Consolidated Condensed Financial Statements**

**(Unaudited)**

**NOTE 9 – SUBSEQUENT EVENTS**

On September 4, 2014, a court in San Benito County ruled that Citadel was required to obtain an environmental impact report before commencing Project Indian. Thereafter, the Court awarded the petitioner \$347,969 as attorney's fees and costs against the County of San Benito and Citadel, jointly and severally. The Company has requested a dismissal of its appeal of this decision which was granted on May 6, 2015 as the Court required the Company to post a bond in which it was unable to qualify for. As such, the Company based upon its best estimate, has booked a contingent liability of \$87,000 for this case.

(table of contents)

## **FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains forward-looking statements and involves risks and uncertainties that could materially affect expected results of operations, liquidity, cash flows, and business prospects. These statements include, among other things, statements regarding:

- exploration risks such as drilling unsuccessful wells;
- our ability to operate profitably;
- our ability to efficiently and effectively finance our operations;
- inability to achieve future sales levels or other operating results;
- inability to raise additional financing for working capital;
- inability to efficiently manage our operations;
- inability to hire or retain sufficient qualified operating field personnel;
- the inability of management to effectively implement our strategies and business plans;
- the unavailability of funds for capital expenditures and/or general working capital;
- deterioration in general or regional economic conditions;

the fact that our accounting policies and methods are fundamental to how we report our financial condition and results of operations, and they may require management to make estimates about matters that are inherently uncertain; changes in U.S. GAAP or in the legal, regulatory and legislative environments in the markets in which we operate; adverse state or federal legislation or regulation that increases the costs of compliance, or adverse findings by a regulator with respect to existing operations;

As well as other statements regarding our future operations, financial condition and prospects, and business strategies. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q, and in particular, the risks discussed under the heading “Risk Factors” in Part II, Item 1A and those discussed in other documents we file with the Securities and Exchange Commission. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

*References in the following discussion and throughout this quarterly report to “we”, “our”, “us”, “Citadel”, “the Company”, and similar terms refer to Citadel Exploration, Inc. and its subsidiary, unless otherwise expressly stated or the context otherwise requires.*

## **AVAILABLE INFORMATION**

We file annual, quarterly and other reports and other information with the SEC. You can read these SEC filings and reports over the Internet at the SEC's website at [www.sec.gov](http://www.sec.gov) or on our website at [www.citadelexploration.com](http://www.citadelexploration.com). You



Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

can also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Please call the SEC at (800) SEC-0330 for further information on the operations of the public reference facilities. We will provide a copy of our annual report to security holders, including audited financial statements, at no charge upon receipt to of a written request to us at Citadel Exploration, Inc., 417 31<sup>st</sup> Street, Unit A, Newport Beach, California 92663.

-14-

[\(table of contents\)](#)

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

### **Overview**

Citadel is an energy company engaged in the exploration and development of oil and natural gas properties. Our properties are located in the Salinas and San Joaquin Basins of California. Subject to availability of capital, we strive to implement an accelerated development program utilizing capital resources, a regional operating focus, an experienced management and technical team, and enhanced recovery technologies to attempt to increase production and increase returns for our stockholders. Our corporate strategy is to build value in the Company through the acquisition of oil and gas leases with significant upside potential, successful exploration and exploitation and the efficient development of these assets.

Our revenues, profitability and future growth depend substantially on prevailing prices for oil and natural gas and our ability to find, develop and acquire oil and gas reserves that are economically recoverable.

### **Our Operations**

Our principal strategy is to focus on the acquisition of oil and natural gas mineral leases that have known hydrocarbons or are in close proximity to known hydrocarbons that have been underdeveloped. Once acquired, we strive to implement an accelerated development program utilizing capital resources, a regional operating focus, an experienced management and technical team, and enhanced recovery technologies to attempt to increase production and increase returns for our stockholders. Our oil and natural gas acquisition and development activities are currently focused in the State of California.

In December of 2014, Citadel began a work-over on the Yowlumne #2-26 well including installation of a new pump in February of 2015. The well has been producing approximately 20- 25 barrels per day (32 degree API gravity) since the beginning of March 2015. Citadel is in the final stages of the CEQA process to permit two additional exploration wells on the Yowlumne acreage and expects to receive those drilling permits in the second quarter of 2015, with drilling to commence in the third quarter of 2015. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 15,000 feet. Citadel currently has a 75% working interest in these exploration prospects and is the operator.

On November 4, 2014 voters in the County of San Benito passed Measure J which bans hydraulic fracturing and other stimulation techniques defined as "high intensity petroleum operations" by the Measure, including cyclic steam injection. The initiative was passed by a count of 8,034 to 5,605. In advance of the initiative passing, the County preemptively passed an ordinance allowing for exemptions from the application of the Measure in the event the Measure would result in a taking. A regulatory taking is a situation in which a government regulation limits the uses

of private property to such a degree that the regulation effectively deprives the property owners of economically reasonable use or value of their property right to such an extent that it deprives them of utility or value of that property right, even though the regulation does not formally divest them of title to it. Accordingly, Citadel Exploration Inc. will provide the County of San Benito the ability to compensate the company for the diminished value at the Indian Oil Field based on the reasonable Unrisked Resource Potential the property would ultimately yield, or allow Citadel to proceed with full field development and cyclic steam injection under the exemption ordinance.

Citadel is currently in the process of evaluating additional oil and natural gas properties for acquisition. The Company's goal is to close on one or more acquisitions in 2015. At such time that an acquisition is made, Citadel will announce its intended capital expenditures plan.

(table of contents)

## **Going Concern**

The financial statements included in this filing have been prepared in conformity with generally accepted accounting principles that contemplate the continuance of the Company as a going concern, which contemplates the realization of assets and liquidation of liabilities in the normal course of business. However, the Company is in the exploration stage and, accordingly, has not generated revenues from operations. As shown on the accompanying financial statements, the Company has incurred a net loss of \$4,194,581 for the period from inception (November 6, 2006) to March 31, 2015. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The future of the Company is dependent upon its ability to obtain financing and upon future profitable operations from the development of its oil and gas business opportunities.

## **RESULTS OF OPERATIONS**

### ***Results of Operations for the Three Months Ended March 31, 2015 and March 31, 2014***

During the three month period ended March 31, 2015 we generated \$20,028 from the sale of oil. During the three month period ended March 31, 2014 we did not generate revenue.

Operating expenses totaled \$245,348 during the three month period ended March 31, 2015 which was a decrease over the period ended March 31, 2014. Operating expenses consisted of general and administrative costs, amortization and depreciation, professional fees, and executive compensation. The decrease consisted primarily of a reduction in general and administrative costs and professional fees. During the period ended March 31, 2014 the Company's operating expense totaled \$301,622.

General and administrative fees decreased from \$96,472 to \$55,887 from the three month period ended March 31, 2014 to the three month period ended March 31, 2015. This decrease was primarily due to insurance, marketing and meals and entertainment expenses.

Professional fees decreased from \$52,439 to \$11,880 from the three month period ended March 31, 2014 to the three month period ended March 31, 2015. The decrease was primarily due to services provided to the Company for accounting, consulting and legal.

Executive compensation increased from \$119,482 to \$162,088 from the three month period ended March 31, 2014 to the three month period ended March 31, 2015. The increase was primarily due to the fair value of the vested stock options and monthly salary as part of the employment agreements with two officers.

### **Liquidity and Capital Resources**

The Company has not yet established a capital budget for 2015. Given the current state of depressed oil prices, the Company is currently evaluating multiple acquisitions. If or when the Company makes an acquisition, at that time we will establish our capital budget for the balance of 2015. We may revise our capital budget during the year as a result of acquisitions and/or drilling outcomes or significant changes in cash flows.

As of March 31, 2015, we had \$97,641 of current assets; of this amount \$45,380 was cash. The following table provides detailed information about the net cash flow for the quarters ended March 31, 2015 and March 31, 2014 as presented in this quarterly report. To date, we have financed our operations through the issuance of stock and borrowings from related parties and an unrelated third party.

(table of contents)

The following table sets forth a summary of our cash flows for the three months ended March 31, 2015 and 2014:

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	2015	2014
Net cash used in operating activities	\$(151,698)	\$(128,488)
Net cash used in investing activities	(173,076)	(415,374)
Net cash provided by financing activities	99,856	498,214
Net change in cash	(224,918)	(52,649 )
Cash, beginning of period	270,298	402,649
Cash, end of period	\$45,380	\$350,000

***Operating activities***

The net loss in the period was greater than the non-cash adjustments to reconcile the changes in the balance sheet and statement of operations, which is the reason cash used in operating activities was negative.

***Investing activities***

The net cash used in investing activities consisted of payment for drilling expenses on oil and gas properties of \$173,076 on the Company's properties.

***Financing activities***

As of March 31, 2015, we continue to use traditional and/or debt financing as well as through the issuance of stock to provide the capital we need to run our business.

Without cash flow from operations we will require additional cash resources, including the sale of equity or debt securities, to meet our planned capital expenditures and working capital requirements for the next 12 months. We will require additional cash resources due to changing business conditions, and or acquisitions we may decide to pursue. If our own financial resources and then current cash-flows from operations are insufficient to satisfy our capital requirements, we may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity securities will result in dilution to our stockholders. The incurrence of indebtedness will result in increased debt service obligations and could require us to agree to operating and financial covenants that could restrict our operations

or modify our plans to grow the business. Financing may not be available in amounts or on terms acceptable to us, if at all. Any failure by us to raise additional funds on terms favorable to us, or at all, will limit our ability to expand our business operations and could harm our overall business prospects.

Our ability to obtain additional capital through additional equity and/or debt financing, and Joint Venture or Working Interest partnerships will also be important to our expansion plans. In the event we experience any significant problems assimilating acquired assets into our operations or cannot obtain the necessary capital to pursue our strategic plan, we may have to reduce the growth of our operations. This may materially impact our ability to increase revenue and develop our assets.

### **Contractual Obligations**

An operating lease for rental office space was entered into beginning March 1, 2013 for two years at \$2,150 per month. The original lease was amended to include additional space at a price of \$1,100 per month for the same term. The company has not yet renewed this lease and is currently renting office space on month to month basis at the previous rate of \$3,250 per month; we plan to enter into a new lease in the coming quarter.

(table of contents)

## **Off-Balance Sheet Arrangements**

As of the date of this report, we did not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

## **Operation Plan**

Our plan is to focus on the acquisition and drilling of prospective oil and natural gas mineral leases. Once we have tested a prospect as productive, subject to availability of capital, we will implement a development program with a regional operating focus in order to increase production and increase returns for our stockholders. Exploration, acquisition and development activities are currently focused in California. Depending on availability of capital, and other constraints, our goal is to increase stockholder value by finding and developing oil and natural gas reserves at costs that provide an attractive rate of return on our investments.

We expect to achieve these results by:

- Investing capital in exploration and development drilling and in secondary and tertiary recovery of oil as well as natural gas;

- Using the latest technologies available to the oil and natural gas industry in our operations;

- Finding additional oil and natural gas reserves on the properties we acquire.

In addition to raising additional capital we plan to take on Joint Venture (JV) or Working Interest (WI) partners who may contribute to the capital costs of drilling and completion and then share in revenues derived from production. This economic strategy may allow us to utilize our own financial assets toward the growth of our leased acreage holdings, pursue the acquisition of strategic oil and gas producing properties or companies and generally expand our existing operations.

Because of our limited operating history we have yet to generate any revenues from the sale of oil or natural gas. Our activities have been limited to raising capital, negotiating WI agreements, becoming a publicly traded company and preliminary analysis of reserves and production capabilities from our exploratory test wells.



Our future financial results will depend primarily on: (i) the ability to continue to source and screen potential projects; (ii) the ability to discover commercial quantities of natural gas and oil; (iii) the market price for oil and natural gas; and (iv) the ability to fully implement our exploration and development program, which is dependent on the availability of capital resources. There can be no assurance that we will be successful in any of these respects, that the prices of oil and gas prevailing at the time of production will be at a level allowing for profitable production, or that we will be able to obtain additional funding to increase our currently limited capital resources.

**Item 3. Quantitative and Qualitative Disclosure About Market Risk**

This item is not applicable as we are currently considered a smaller reporting company.

(table of contents)

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

Our Chief Executive Officer, Armen Nahabedian, and our Chief Financial Officer, Philip McPherson evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this Report. Based on that evaluation and assessment, Mr. Armen Nahabedian and Mr. Philip McPherson concluded that our disclosure controls and procedures are not designed at a reasonable assurance level and are not effective to provide reasonable assurance that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control Over Financial Reporting*

There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

*Limitations on Effectiveness of Controls and Procedures*

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

(table of contents)

## **PART II—OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We received notice on or about July 10, 2013 that the Center for Biological Diversity (“CBD”) had filed a law suit against the County of San Benito regarding the approval of Project Indian which is described more fully, above, as the “Case”. The Board of Supervisors voted 5-0 in favor of our application to drill 15 exploration wells on our Project Indian lease. The Court approved the petition in a judgment entered on September 4, 2014, and ruled that Citadel was required to obtain an environmental impact report before commencing Project Indian. Thereafter, the Court awarded the petitioner \$347,969 as attorney’s fees and costs against the County of San Benito and Citadel, jointly and severally. The Company has requested a dismissal of its appeal of this decision which was granted as the Court required the Company to post a bond in which it was unable to qualify for. As such, the Company based upon its best estimate, has booked a contingent liability of \$87,000 for this case.

On November 4, 2014 voters in the County of San Benito passed Measure J which bans hydraulic fracturing and other stimulation techniques defined as “high intensity petroleum operations” by the Measure, including steam injection. The initiative was passed by a count of 8,034 to 5,605. In advance of the initiative passing, the County preemptively passed an ordinance allowing for exemptions from the application of the Measure in the event the Measure would result in a taking. A regulatory taking is a situation in which a government regulation limits the uses of private property to such a degree that the regulation effectively deprives the property owners of economically reasonable use or value of their property right to such an extent that it deprives them of utility or value of that property right, even though the regulation does not formally divest them of title to it. Accordingly, Citadel Exploration Inc. will provide the County of San Benito the ability to compensate the company for the diminished value at the Indian Oil Field based on the reasonable Unrisked Resource Potential the property would ultimately yield, or allow Citadel to proceed with full field development and steam injection under the exemption ordinance.

On February 27<sup>th</sup>, 2015, Citadel sued the County of San Benito on the basis that Measure J and its enabling ordinance are preempted by the law of the State of California. Specifically, the complaint alleges that the power and authority to regulate the down-hole operations of oil and gas exploration and production is vested exclusively in the Division of Oil, Gas, and Geothermal Resources of the Department of Conservation. It further alleges that the County’s Measure and its ordinance are preempted by State law as the regulation of down-hole operations is exclusively a State function, and that the County lacks the power and authority to regulate down-hole operations. On April 3, 2015 Citadel dismissed the complaint, without prejudice. At this time Citadel has reserved its rights, with respect to the Indian Oil Field, including claims for inverse condemnation.

### **Item 1A. Risk Factors.**

Our significant business risks are described in Item 1A. to Part I of Form 10-K for the year ended December 31, 2014 (filed April 16, 2015) to which reference is made herein.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

*Stock Issuances pursuant to Subscription Agreements*

In December 2014, the Company approved the issuance of 500,000 common stock shares for engineering, legal, accounting and marketing services performed in the fourth quarter of 2014.

In March of 2015, the Company approved the issuance of 1,400,000 common stock shares and issued 25,000 shares recorded as a stock payable at December 31, 2014, for the conversion of a \$100,000 promissory note, plus accrued interest of \$2,164 and an additional capital investment of \$107,835, all at \$0.15 per share.

(table of contents)

We believe that the issuance and sale of the above securities were exempt from the registration and prospectus delivery requirements of the Securities Act of 1933 by virtue of Section 4(2), Regulation D and/or Regulation S. The securities were issued directly by us and did not involve a public offering or general solicitation. The recipient of the securities was afforded an opportunity for effective access to files and records of our company that contained the relevant information needed to make her investment decision, including our financial statements and 34 Act reports. We reasonably believed that the recipient, immediately prior to issuing the securities, had such knowledge and experience in our financial and business matters that she was capable of evaluating the merits and risks of its investment. The recipient had the opportunity to speak with our management on several occasions prior to her investment decision. There were no commissions paid on the issuance and sale of the shares.

***Option Grants***

Our option grants are described in Form 10-K for the year ended December 31, 2013 (filed April 14, 2014) to which reference is made herein.

***Subsequent Stock Issuances***

None.

**Issuer Purchases of Equity Securities**

We did not repurchase any of our equity securities from the time of our inception on November 6, 2006 through the period ended March 31, 2014.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

***2012 Stock Incentive Plan***

On September 1, 2012, we adopted the 2012 Stock Incentive Plan. We have reserved for issuance an aggregate of 10,000,000 shares of common stock under our 2012 Stock Incentive Plan. To date 4,800,000 options and no shares of common stock have been granted under this plan.

Our employment agreements with executive officers are described in Form 10-K for the year ended December 31, 2014 (filed April 16, 2015) to which reference is made herein.

-21-

(table of contents)**Item 6. Exhibits.**

<b>Exhibit No.</b>	<b>Description</b>
10.4	2012 Stock Incentive Plan
31.1	<u>Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certifications of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Certifications of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase
101.DEF*	XBRL Taxonomy Extension Definition Linkbase
101.LAB*	XBRL Taxonomy Extension Label Linkbase
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase

*XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.*

(table of contents)

**SIGNATURE**

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.

**CITADEL EXPLORATION, INC.**

Date: May 20, 2015 By: /S/ Armen Nahabedian  
Armen Nahabedian  
Chief Executive Officer  
(Principal Executive Officer and duly authorized signatory)

-23-



