

Citadel Exploration, Inc.
Form 10-Q
May 15, 2014

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, 2014

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 31st Street, Unit A
Newport Beach, California 92663
(Address of principal executive offices)

(949) 612-8040
(Registrant's telephone number, including area code)

Copies of Communications to:
Rutan & Tucker
611 Anton Blvd, 14th Floor Costa Mesa, CA 92626
(714) 641-3487
Fax (714) 546-9035

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 (Do not check if a smaller reporting company)

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 13, 2014 was 29,714,000 shares.

CITADEL EXPLORATION, INC.
QUARTERLY PERIOD ENDED MARCH 31, 2014

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

CITADEL EXPLORATION, INC. AND SUBSIDIARY
(AN EXPLORATION STAGE COMPANY)
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash	\$ 350,000	\$ 402,649
Other receivable	21,600	40,660
Prepaid expenses	83,073	41,589
Product inventory	4,881	4,881
Total current assets	459,554	489,779
Deposits	4,000	4,000
Restricted cash	45,000	45,000
Oil and gas properties	1,787,981	1,373,363
Fixed assets, net	27,659	12,633
Total assets	\$ 2,324,194	\$ 1,924,775
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 424,025	\$ 435,332
Accrued interest payable	-	8,316
Notes payable, net	406,348	314,134
Total current liabilities	830,373	757,782
Asset retirement obligation	48,923	31,407
Total liabilities	879,296	789,189
Stockholders' equity:		
Common stock, \$0.001 par value, 100,000,000 shares authorized, 29,714,000 and 28,949,823 shares issued and outstanding as of March 31, 2014 and December 31, 2013, respectively	29,714	28,950
Additional paid-in capital	3,904,459	3,332,982
Deficit accumulated during development stage	(2,489,275)	(2,226,346)
Total stockholders' equity	1,444,898	1,135,586

Total liabilities and stockholders' equity	\$2,324,194	\$1,924,775
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See Accompanying Notes to Consolidated Financial Statements.

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

	For the three months ended March 31,		Inception (November 6, 2006) to March 31, 2014
	2014	2013	
Revenue	\$-	\$-	\$9,223
Operating expenses:			
Lease operating expense	27,882	-	113,217
Geological and geophysical expense	2,100	-	8,404
General and administrative	96,472	55,283	658,508
Depreciation, amortization and accretion	3,247	2,079	15,627
Professional fees	52,439	150,360	811,267
Executive compensation	119,482	97,498	825,666
Gain on sale of interest in oil & gas properties	-	-	(267,856)
Gain on settlement of accounts payable	-	-	(6,161)
Total operating expenses	301,622	305,220	2,158,672
Other expenses:			
Gain - other	8,316	-	8,316
Gain - note payable settlement	33,545	-	33,545
Interest expense	(3,168)	(112,169)	(372,658)
Total other expenses	38,693	(112,169)	(330,797)
Net loss before provision for income taxes	(262,929)	(417,389)	(2,480,246)
Provision for income taxes	-	-	9,029
Net loss	\$(262,929)	\$(417,389)	\$(2,489,275)
Weighted average number of common shares outstanding - basic and diluted	29,714,000	25,813,834	
Net loss per share - basic and diluted	\$(0.01)	\$(0.02)	

See Accompanying Notes to Consolidated Financial Statements.

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

	For the three months ended March 31,		Inception (November 6, 2006) to March 31, 2014
	2014	2013	
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	\$ (262,929)	\$ (417,389)	\$ (2,489,275)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation, amortization and accretion	3,247	2,079	15,627
Amortization of prepaid stock compensation	-	-	80,000
Amortization of debt discount	2,450	84,517	313,530
Gain on sale of interest in oil & gas properties	-	-	(267,856)
Non cash interest expense	-	22,500	22,500
Gain on settlement of accounts payable	-	-	(6,161)
Gain - other	(8,316)	-	(8,316)
Gain on settlement of note payable	(33,545)	-	(33,545)
Stock based compensation expense	37,498	37,498	337,486
Shares issued for consulting	110,775	116,000	275,205
Changes in operating assets and liabilities:			
Decrease (increase) in other receivables	19,060	(37,009)	(21,600)
Decrease (increase) in prepaid expense	7,079	(8,367)	30,666
Increase in product inventory	-	-	(4,881)
Increase in deposits	-	(3,150)	(4,000)
Increase (decrease) in accounts payable and accrued liabilities	(3,807)	50,494	467,235
Decrease in accrued interest payable	-	(6,508)	8,316
Net cash used in operating activities	(128,488)	(159,335)	(1,285,069)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase oil and gas properties	(397,210)	(26,741)	(1,821,376)
Proceeds from sale of interest in oil & gas properties	-	-	350,000
Purchase of fixed assets	(18,165)	-	(43,112)
Restricted cash	-	-	(45,000)

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Net cash used in provided by investing activities	(415,375)	(26,741)	(1,559,488)
CASH FLOWS FROM FINANCING ACTIVITIES			
Member contributions	-	-	105,523
Member distribution	-	-	10,000
Proceeds from sale of common stock, net of costs	(652)	1,410,711	2,035,773
Proceeds from notes payable	500,000	-	1,318,274
Repayments for notes payable	(8,134)	(31,737)	(275,013)
Net cash provided by financing activities	491,214	1,378,974	3,194,557
NET CHANGE IN CASH	(52,649)	1,192,898	350,000
CASH AT BEGINNING OF PERIOD	402,649	112,580	-
CASH AT END OF PERIOD	\$ 350,000	\$ 1,305,478	\$ 350,000

SUPPLEMENTAL INFORMATION:

Interest paid	\$ (429)	\$ -	\$ 3,629
Income taxes paid	\$ -	\$ -	\$ 3,200
NON-CASH INVESTING AND FINANCING ACTIVITIES			
Liabilities assumed with the acquisition of Citadel Exploration, LLC	\$ -	\$ -	\$ 29,265
Asset Retirement Obligation	\$ 17,408	\$ -	\$ 48,749
Shares issued for prepaid stock compensation	\$ -	\$ -	\$ 80,000
Financing of prepaid insurance	\$ 45,000	\$ 41,250	\$ 124,869
Issuance of stock for prepaid rent	\$ -	\$ -	\$ -
Forgiveness of debt due to related party	\$ -	\$ -	\$ 50,953
Issuance of common stock for settlement of notes payable and accrued interest	\$ 307,500	\$ 310,298	\$ 617,799

See Accompanying Notes to Consolidated Financial Statements.

CITADEL EXPLORATION, INC. AND SUBSIDIARY
(AN EXPLORATION STAGE COMPANY)
Notes to Consolidated 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

For the three months ended March 31, 2014 and 2013, the consolidated 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.

Cash and cash equivalents

The Company considers all highly liquid instruments with maturity of three months or less at the time of issuance to be cash equivalents.

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.

CITADEL EXPLORATION, INC. AND SUBSIDIARY
 (AN EXPLORATION STAGE COMPANY)
 Notes to Consolidated Financial Statements
 (Unaudited)

Recent pronouncements

The Company has evaluated the recent accounting pronouncements through May 2014 and believes that none of them will have a material effect on the company's financial statements.

NOTE 2 – GOING CONCERN

The accompanying consolidated 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 is in the exploration stage and, accordingly, has not yet generated revenues from operations. 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, 2014 of \$2,489,275. 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 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 capitalized in oil and gas properties as of March 31, 2014 and December 31, 2013 are as follows:

	2014	2013
Exploration	\$1,787,981	\$1,373,363

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 during as of March 31, 2014:

	2014
Beginning balance at January 1, 2014	\$ 1,373,363
Additions to capitalized exploratory well costs pending the determination of proved reserves	397,101
Asset retirement obligation	17,517
Ending balance at March 31	\$ 1,787,981

CITADEL EXPLORATION, INC. AND SUBSIDIARY
(AN EXPLORATION STAGE COMPANY)
Notes to Consolidated Financial Statements
(Unaudited)

Project Indian

On January 31, 2009, the Company entered into an oil, gas and mineral lease in San Benito County, California with an unrelated third party for the right to develop and operate the leased premises for an initial term of three years. The lease will continue as long as the Company continues actual drilling operations and continued development. The Company is obligated to pay royalties to the unrelated third party on oil and gas from all wells on the leased premises, and the royalty is a total of 20% of the market value. On February 1, 2012, the Company renegotiated this oil, gas and mineral lease for an additional minimum term of two years. The terms of the renegotiated lease are substantially the same as the original lease disclosed above. On February 1, 2013, the Company paid the final amount due to the mineral owner for this lease.

On February 22, 2012, the Company sold 40% of its interest in the property disclosed above in exchange for \$350,000 to its joint venture partner. The Company recorded a gain on the sale of the partial interest totaling \$267,856. Drilling commenced on this property in January 2014. Indian #1-15 was drilled and cased with Citadel paying 100% of the costs. The Company is now proceeding with completion and thermal recovery operations to determine the commercial viability of the project.

On May 5, 2104 the Company received its steam injection permit from DOGGR, and expects steam injection to begin in the month of May.

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

Yowlumne

In May 2013, the Company entered into a one year lease for approximately 3,000 acres from AERA Energy, LLC. 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 royalties to AERA Energy, LLC on oil and gas from all wells on the leased premises, and the royalty is a total of 20% of the market value. In August of 2013, the Company entered into an agreement to sell 75% of the interest in the Yowlumne lease, recouping approximately 85% of its cost, while retaining a 25% interest in the lease and operatorship. Additionally, as part of this transaction, the Company retained 100% interest in the Yowlumne #2 well, which was originally drilled in 2007. After performing a workover job on this well, it has produced approximately 120 barrels of oil which were sold in December 2013. As of year-end 2013, the well had produced approximately 50 barrels of oil which were stored in a tank and valued at net realizable value on the balance sheet as product inventory.

NOTE 4 – NOTES PAYABLE

Notes payable consists of the following at:

	March 31, 2014	December 31, 2013
Three notes payable to individuals, 10% interest, due January 1, 2014	\$-	\$300,000
	51,000	14,134

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Three notes payable to an entity for the financing of insurance premiums, unsecured; 14% interest, due December 2013; 14% interest, due February 2014; 11% interest, due August 2014

Two notes payable to individuals, 10% interest, due September 30, 2014	500,000	-
Debt discount for 500,000 warrants issued with notes payable	(144,652)	-
	\$406,348	\$314,134

During the quarter ended March 31, 2014, the Company settled the \$300,000 note payable with 559,092 shares valued at \$273,955, resulting in a gain on the settlement of note payable of \$33,545.

CITADEL EXPLORATION, INC. AND SUBSIDIARY
(AN EXPLORATION STAGE COMPANY)
Notes to Consolidated Financial Statements
(Unaudited)

Interest expense for the quarter ended March 31, 2014 was \$3,168. Of that amount, \$715 relates to notes payable and insurance financing and \$2,452 is amortization of debt discount. Interest expense for the quarter ended March 31, 2013 was \$112,169.

In March 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 the investors received 500,000 warrants to purchase the Company's stock at \$1.00 per share for a term of two years.

NOTE 5 – STOCKHOLDERS' EQUITY

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

In February 2013, the Company issued 4,186,000 shares of restricted common stock for cash consideration of \$1,423,240 or \$0.34 per share, less issuance cost of \$12,531.

In February 2013, the Company issued 912,640 shares of restricted common stock for the conversion of loans and interest in the amount of \$310,298. The fair value of the shares at the date of settlement was \$332,798, which resulted in the Company recording \$22,500 in additional interest expense.

In February 2013, the Company issued 320,000 shares of restricted common stock valued at \$116,000 to various parties for accounting, legal and marketing services.

In September 2013, the Company closed on a \$200,000 bridge loan from two individuals. In October, the Company closed an additional \$100,000 bridge loan from one investor. These notes have a 90 day term and bear interest of 10%. Additionally, each investor received 100,000 warrants to purchase the Company's stock at \$1.00 per share for a term of one year valued at \$93,750 in total.

In December 2013, the Company approved the issuance of 918,183 common stock shares for \$505,000 cash for payment to investors whose funds were received in December 2013. The shares were issued during January 2014.

In January 2014, the Company issued 205,085 shares of common stock for services rendered and prepaid expenses with a value of \$114,338. Also in January 2014, the Company issued 1,477,275 shares of common stock at a price of \$0.55 per share. This included the conversion of \$300,000 in previously issued bridge loans plus accrued interest and new equity capital of \$505,000. These shares were approved by the Company's board during the previous year, and as such were shown as issued and outstanding as of December 31, 2013.

NOTE 6 – 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 three months ended March 31, 2014, \$x was recorded as a stock based compensation expense.

CITADEL EXPLORATION, INC. AND SUBSIDIARY
(AN EXPLORATION STAGE COMPANY)
Notes to Consolidated Financial Statements
(Unaudited)

The following is a summary of the status of all of the Company's stock options as of March 31, 2014 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, 2013	4,000,000	\$ 0.20	5.68
Granted	-	\$ 0.00	-
Exercised	-	\$ 0.00	-
Cancelled	-	\$ 0.00	-
Outstanding at March 31, 2014	4,000,000	\$ 0.20	5.43
Exercisable at March 31, 2014	1,000,000	\$ 0.20	5.43

NOTE 7 – 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 amortization of debt discount and included in interest expense.

In September 2013, the Company 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 valued at \$56,283. An additional \$100,000 note payable with the same terms and warrants which were valued at \$37,467 was issued in October 2013.

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 \$147,104. 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%. During the quarter ended March 31, 2014, \$2,450 was recorded amortization of debt discount and included in interest expense.

The following is a summary of the status of all of the Company's stock warrants as of March 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, 2014	800,000	\$ 0.72	0.86
Granted	500,000	\$ 1.00	1.99
Exercised	-	\$ 0.00	-
Cancelled	-	\$ 0.00	-
Outstanding at March 31, 2014	1,300,000	\$ 0.83	1.14

Exercisable at March 31, 2014	800,000	\$	0.72	0.61
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NOTE 8 – SUBSEQUENT EVENTS

On May 5, 2014 the Company received its steam injection permit for Project Indian from the Division of Oil & Gas and Geothermal (“DOGGR”).

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:

- o exploration risks such as drilling unsuccessful wells;
 - o our ability to operate profitably;
- o our ability to efficiently and effectively finance our operations;
- o inability to achieve future sales levels or other operating results;
 - o inability to raise additional financing for working capital;
 - o inability to efficiently manage our operations;
- o inability to hire or retain sufficient qualified operating field personnel;
- o the inability of management to effectively implement our strategies and business plans;
- o the unavailability of funds for capital expenditures and/or general working capital;
 - o deterioration in general or regional economic conditions;
- o 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;
- o changes in U.S. GAAP or in the legal, regulatory and legislative environments in the markets in which we operate;
- o 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 or on our website at www.citadelexploration.com. You 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 31st Street, Unit A, Newport Beach, California 92663.

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.

To date, the Yowlumne 2-26 well has recovered approximately 120 barrels of oil, which were sold to Kern Oil Refinery ("KOR") in the fourth quarter of 2013, marking the Company's first revenue. The well then experienced some mechanical issues, and the Company is currently working with its engineers on additional workover and stimulation plans. The Company expects to commence workover operations upon receiving its permit for such operations from the DOGGR. In 2013, the State of California passed Senate Bill #4 ("SB 4") which required additional disclosures regarding fracturing ("fracking"), and/or well stimulation. The Company has submitted an updated permit application to comply with this new regulation.

Citadel has also started permitting two additional exploration wells on the Yowlumne acreage and expects to receive those drilling permits in the third quarter of 2014, with drilling to commence in the fourth quarter of 2014. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 14,000 feet. Citadel currently has a 25% working interest in these exploration prospects and is the operator.

Currently at Project Indian, we have drilled and completed our first well (Indian #1-15). On May 5, 2014 we received our permit from the DOGGR for steam injection at Project Indian. Steam injection is anticipated to begin in the month of May. We will begin thermal injection under a method called cyclic steam injection. This method will consist of injecting steam for a period of 8 to 10 days, then allowing the steam to heat the reservoir for a period of 3 to 5 days, and then placing the well on production for approximately 15 to 20 days. This process will allow the Company to collect important data on how the reservoir is responding to steam. This data will be used to determine the wells steam to oil ratio, allowing the Company to understand the full cycle economics for this well and eventually the entire field. Citadel is currently in negotiations with Sojitz regarding their ownership and future interest in Project Indian.

Starting in May of 2013, Citadel participated in three exploration wells at the Rancho Grande area, with a 20 to 22% non-operated working interest. Sojitz Energy Ventures of Houston was the operator. To date, the three exploration

wells have not produced commercial quantities of oil. Citadel believes that these wells need further testing, however the operator has shifted its focus to deeper exploration targets in the same area, in which Citadel elected not to participate. Currently the joint venture partners are in negotiations on the next course of action at Rancho Grande, which we believe will be determined in the second quarter of 2014.

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 \$2,489,275 for the period from inception (November 6, 2006) to March 31, 2014. 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, 2014 and March 31, 2013

During the three month period ended March 31, 2014 and 2013 we did not generate revenue.

Operating expenses totaled \$301,622 during the three month period ended March 31, 2014 which was a slight decrease over the period ended March 31, 2013. Operating expenses consisted of general and administrative costs, amortization and depreciation, professional fees, and executive compensation. During the period ended March 31, 2013 the Company's operating expenses totaled \$305,220.

General and administrative fees increased from \$55,283 to \$96,472 from the three month period ended March 31, 2013 to the three month period ended March 31, 2014. This increase was primarily due to insurance, marketing and meals and entertainment expenses.

Professional fees decreased from \$150,360 to \$52,439 from the three month period ended March 31, 2013 to the three month period ended March 31, 2014. The decrease was primarily due to services provided to the Company for accounting, consulting and legal.

Executive compensation increased from \$97,498 to \$119,482 from the three month period ended March 31, 2013 to the three month period ended March 31, 2014. 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 established a capital budget for 2014 of approximately \$2,000,000 for Project Indian, Yowlumne and additional lease acquisitions. 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, 2014, we had \$459,554 of current assets, of this amount \$350,000 was cash. The following table provides detailed information about the net cash flow for the quarters ended March 31, 2014 and March 31, 2013 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.

The following table sets forth a summary of our cash flows for the three months ended March 31, 2014 and 2013:

	Three Months Ended March 31,	
	2014	2013
Net cash used in operating activities	\$(128,488)	\$(159,335)
Net cash used in investing activities	(415,375)	(26,741)
Net cash provided by financing activities	491,214	1,378,974
Net change in cash	(52,649)	1,192,898
Cash, beginning of period	402,649	112,580
Cash, end of period	\$350,000	\$1,305,478

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

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The net cash used in investing activities consisted of payment for drilling expenses on oil and gas properties of \$397,210 on the Company's properties.

Financing activities

The net cash provided by financing activities consisted primarily of cash provided from the issuance of two notes payable for \$500,000, net of cash payments \$8,314.

As of March 31, 2014, 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 changed business conditions, implementation of our strategy to successfully develop our Shallow Indian Oil Development Project, exploration drilling at Rancho Grande 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.

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.

Item 4T. 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.

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 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 our drilling permits for our Project Indian. The Board of Supervisors of San Benito County voted 5-0 in favor of our application to drill 15 exploration wells on our Project Indian lease. We believe the actions taken by the CBD are unwarranted and will vigorously defend our property rights that have been granted to us via our lease agreement.

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, 2013 (filed April 14, 2014) 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 918,183 common stock shares for \$505,000 cash for payment to investors whose funds were received in December 2013. The shares were issued during January 2014.

In January 2014, the Company issued 205,085 common stock shares for cash for payment to investors for funds received in December 2013. Also in January 2014, the Company issued 1,477,275 shares at a price of \$0.55 per share. This included the conversion of \$300,000 in previously issued bridge loans plus accrued interest and new equity capital of \$505,000. These shares were approved by the Company's board during the previous year, and such were shown as issued and outstanding as of December 31, 2013.

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 4,000,000 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, 2013 (filed April 14, 2014) to which reference is made herein.

Item 6. Exhibits.

Exhibit No.	Description
10.4	2012 Stock Incentive Plan
31.1	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
31.2	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
32.1	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
32.2	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
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.

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 15, 2014

By:

/S/ Armen Nahabedian
Armen Nahabedian
Chief Executive Officer
(Principal Executive Officer and duly authorized
signatory)

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