

Citadel Exploration, Inc.  
Form 10-Q  
August 20, 2012

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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 June 30, 2012

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.)

420 Bryant Circle, Unit D  
Ojai, California 93023  
(Address of principal executive offices)

(530) 871-1484  
(Registrant's telephone number, including area code)

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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 July 20, 2012 was 20,362,500 shares.

CITADEL EXPLORATION, INC.  
QUARTERLY PERIOD ENDED JUNE 30, 2012

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements.

CITADEL EXPLORATION, INC.  
(FORMERLY SUBPRIME ADVANTAGE, INC.)  
(A DEVELOPMENT STAGE COMPANY)  
CONSOLIDATED BALANCE SHEETS  
(unaudited)

|   | June 30,<br>2012 | December 31,<br>2011 |
|---|------------------|----------------------|
| <b>ASSETS</b>   |                  |                      |
| Current assets:   |                  |                      |
| Cash  | \$ 12,857        | \$ 1,245             |
| Other receivable  | 2,047            | -                    |
| Prepaid expenses  | 16,518           | 16,664               |
| Prepaid stock compensation  | 20,000           | 60,000               |
| Total current assets  | 51,422           | 77,909               |
| Oil and gas properties  | 146,169          | 205,360              |
| Website, net  | 878              | 1,108                |
| Total assets  | \$ 198,469       | \$ 284,377           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY<br/>(DEFICIT)</b>   |                  |                      |
| Current liabilities:  |                  |                      |
| Overdraft in trust account  | \$ -             | \$ 286               |
| Accounts payable  | 39,815           | 107,709              |
| Accounts payable - related party  | 50,953           | -                    |
| Accrued interest payable  | 4,649            | 1,907                |
| Accrued interest payable - related party  | 4,230            | 2,504                |
| Notes payable   | 68,679           | 55,498               |
| Notes payable - related party   | 55,690           | 131,450              |
| Total current liabilities   | 224,016          | 299,354              |
| Total liabilities   | 224,016          | 299,354              |
| Stockholders' equity (deficit):   |                  |                      |
| Common stock, \$0.001 par value, 100,000,000 shares<br>authorized, 20,362,500 and 20,320,000 shares issued<br>and outstanding |                  |                      |

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as of June 30, 2012 and December 31, 2011,  
 respectively

|  |            |            |
|--|------------|------------|
|  | 20,363     | 20,320     |
| Additional paid-in capital                           | 195,895    | 160,958    |
| Stock payable  | -          | 34,000     |
| Deficit accumulated during development stage         | (241,805 ) | (230,255 ) |
| Total stockholders' equity (deficit)                 | (25,547 )  | (14,977 )  |
| Total liabilities and stockholders' equity (deficit) | \$ 198,469 | \$ 284,377 |

See Accompanying Notes to Consolidated Financial Statements.

CITADEL EXPLORATION, INC.  
(FORMERLY SUBPRIME ADVANTAGE, INC.)  
(A DEVELOPMENT STAGE COMPANY)  
CONSOLIDATED STATEMENT OF OPERATIONS  
(unaudited)

|  | For the three months<br>ended<br>June 30, |              | For the six months<br>ended<br>June 30, |              | (Inception)<br>November<br>6, 2006<br>to<br>June 30,<br>2012 |
|--|---|--------------|---|--------------|--|
|  | 2012                                      | 2011         | 2012                                    | 2011         |  |
| Revenue  | \$-                                       | \$-          | \$-                                     | \$-          | \$-  |
| Operating expenses:  |   |              |   |              |  |
| General and administrative                                   | 38,715                                    | 6,324        | 56,431                                  | 7,717        | 120,889  |
| General and administrative - related party                   | 31,465                                    | -            | 62,930                                  | -            | 62,930   |
| Amortization   | 114                                       | 38           | 229                                     | 38           | 496  |
| Professional fees  | 49,421                                    | 111,597      | 95,734                                  | 111,597      | 249,042  |
| Professional fees - related party                            | 30,000                                    | -            | 60,000                                  | -            | 60,000   |
| Gain on sale of interest in oil & gas properties             | -   | -            | (267,856 )                              | -            | (267,856 )   |
| Gain on settlement of accounts payable                       | -   | -            | (661 )                                  | -            | (661 )   |
| Total operating expenses                                     | 149,715                                   | 117,959      | 6,807                                   | 119,352      | 224,840  |
| Other expenses:  |   |              |   |              |  |
| Interest expense   | (1,653 )                                  | -            | (3,017 )                                | -            | (6,906 )   |
| Interest expense - related party                             | (580 )                                    | (351 )       | (1,726 )                                | (351 )       | (4,230 )   |
| Total other expenses   | (2,233 )                                  | (351 )       | (4,743 )                                | (351 )       | (11,136 )  |
| Net loss before provision for income taxes                   | (151,948 )                                | (118,310 )   | (11,550 )                               | (119,703 )   | (235,976 )   |
| Provision for income taxes                                   | -   | -            | -                                       | -            | (5,829 )   |
| Net loss   | \$(151,948 )                              | \$(118,310 ) | \$(11,550 )                             | \$(119,703 ) | \$(241,805 )   |
| Weighted average number of common shares outstanding - basic |   |              |   |              |  |
|  | 20,320,000                                | 20,214,237   | 20,320,000                              | 16,025,635   |  |
| Net loss per share - basic                                   | \$(0.01 )                                 | \$(0.01 )    | \$(0.00 )                               | \$(0.01 )    |  |

See Accompanying Notes to Consolidated Financial Statements.



CITADEL EXPLORATION, INC.  
(FORMERLY SUBPRIME ADVANTAGE, INC.)  
(A DEVELOPMENT STAGE COMPANY)  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(unaudited)

|  | For the six months<br>ended<br>June 30, |              | (Inception)<br>November<br>6, 2006<br>to<br>June 30,<br>2012 |
|--|---|--------------|--|
|  | 2012                                    | 2011         |  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                    |   |              |  |
| Net loss   | \$(11,550 )                             | \$(119,703 ) | \$(241,805 )   |
| Adjustments to reconcile net loss<br>to net cash used in operating activities: |   |              |  |
| Amortization   | 229                                     | 38           | 496  |
| Amortization of prepaid stock compensation                                     | 40,000                                  | -            | 60,000   |
| Gain on sale of interest in oil & gas properties                               | (267,856 )                              | -            | (267,856 )   |
| Gain on settlement of accounts payable   | (661 )                                  |              | (661 )   |
| Changes in operating assets and liabilities:                                   |   |              |  |
| Increase in other receivable   | (2,047 )                                | -            | (2,047 )   |
| (Increase) decrease in prepaid expenses  | 15,109                                  | -            | (1,555 )   |
| Increase (decrease) in accounts payable  | (67,233 )                               | 28,627       | 11,011   |
| Increase in accounts payable - related party                                   | 50,953                                  | -            | 50,953   |
| Increase in accrued interest payable   | 2,742                                   | -            | 4,649  |
| Increase in accrued interest payable - related party                           | 1,726                                   | 351          | 4,230  |
| Net cash used in operating activities  | (238,588 )                              | (90,687 )    | (382,585 )   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                    |   |              |  |
| Purchase oil and gas properties  | (35,221 )                               | (66,780 )    | (240,581 )   |
| Proceeds from sale of interest in oil & gas properties                         | 350,000                                 | -            | 350,000  |
| Website  | -                                       | (1,375 )     | (1,375 )   |
| Net cash provided by (used in) investing activities                            | 314,779                                 | (68,155 )    | 108,044  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                    |   |              |  |
| Increase in overdraft from trust account                                       | (286 )                                  | -            | -  |
| Member contributions   | -                                       | -            | 104,543  |
| Member distribution  | -                                       | -            | 10,000   |
| Proceeds from sale of common stock, net of offering costs                      | -                                       | 77,761       | 50,000   |
| Proceeds from notes payable  | 13,381                                  | -            | 68,879   |
| Repayments for notes payable   | (1,714 )                                | -            | (1,714 )   |
| Proceeds from notes payable - related party                                    | 26,040                                  | 81,200       | 157,690  |
| Repayments for notes payable - related party                                   | (102,000 )                              | -            | (102,000 )   |
| Net cash provided by financing activities                                      | (64,579 )                               | 158,961      | 287,398  |



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|  |          |       |          |
|--|----------|-------|----------|
| NET CHANGE IN CASH   | 11,612   | 119   | 12,857   |
| CASH AT BEGINNING OF YEAR  | 1,245    | -     | -        |
| CASH AT END OF YEAR  | \$12,857 | \$119 | \$12,857 |
| SUPPLEMENTAL INFORMATION:  |          |       |          |
| Interest paid  | \$-      | \$-   | \$-      |
| Income taxes paid  | \$-      | \$-   | \$-      |
| NON CASH TRANSACTIONS:   |          |       |          |
| Liabilities assumed with the acquisition of Citadel Exploration, LLC | \$-      | \$-   | \$29,265 |
| Shares issued for prepaid stock compensation                         | \$-      | \$-   | \$80,000 |
| Financing of prepaid insurance                                       | \$14,963 | \$-   | \$14,963 |

See Accompanying Notes to Consolidated Financial Statements.

Citadel Exploration, Inc.  
(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, 2011 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 and six months ended June 30, 2012 and 2011, 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 significant 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.

Citadel Exploration, Inc.  
(An Exploration Stage Company)  
Notes to Consolidated Financial Statements  
(Unaudited)

Stock-based compensation

The Company records stock based compensation in accordance with the guidance in ASC Topic 718 which requires the Company to recognize expense related to the fair value of its employee stock option awards. This eliminates accounting for share-based compensation transactions using the intrinsic value and requires instead that such transactions be accounted for using a fair-value-based method. The Company recognizes the cost of all share-based awards on a graded vesting basis over the vesting period of the award.

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 year. 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.

Oil and gas properties

The Company uses the full cost method of accounting for its oil and natural gas properties. Under this method, all acquisition, exploration, development and estimated abandonment costs incurred for the purpose of acquiring and finding oil and natural gas are capitalized within cost centers. At June 30, 2012 and December 31, 2011, the Company had one cost center – California. Unevaluated property costs are excluded from the amortization base until determination of the existence of proved reserves on the respective property or until the requirement for impairment. Unevaluated properties are reviewed at the end of each quarter to determine whether portions of the costs should be reclassified to the full cost pool and thereby subject to amortization. Sales of oil and natural gas properties are accounted for as adjustments to the net full cost pool with no gain or loss recognized, unless the adjustment would significantly alter the relationship between capitalized costs and proved reserves.

Capitalized costs of oil and natural gas properties evaluated as having, or not having, proved reserves are amortized in the aggregate by country using the unit-of-production method based upon estimated proved oil and natural gas reserves. For amortization purposes, relative volumes of oil and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil. Amortizable costs include estimates of future development costs of proved undeveloped reserves. The costs of properties not yet evaluated are not amortized until evaluation of the property. Such evaluations for a well and associated lease rights are made when it is determined whether or not the well has proved oil and natural gas reserves. Other unevaluated properties are evaluated for impairment as of the end of each calendar quarter based upon various factors at the time, including drilling plans, drilling activity, management’s estimated fair values of lease rights by project, and remaining lives of leases.

Citadel Exploration, Inc.  
(An Exploration Stage Company)  
Notes to Consolidated Financial Statements  
(Unaudited)

Capitalized costs of oil and natural gas properties (net of related deferred income taxes) may not exceed a ceiling amount equal to the present value, discounted at 10% per annum, of the estimated future net cash flows from proved oil and natural gas reserves plus the cost of unevaluated properties (adjusted for related income tax effects). Should capitalized costs exceed this ceiling amount, the excess is charged to earnings as an impairment expense, net of its related reduction of the deferred income tax provision. The present value of estimated future net cash flows is computed by applying the twelve-month historical averages of prices of oil and natural gas to estimated future production of proved oil and natural gas reserves as of period-end, less estimated future expenditures (at period-end rates) to be incurred in developing and producing the proved reserves and assuming continuation of economic conditions existing at period-end. The present value of future net cash flows of proved reserves excludes future cash outflows associated with settling asset retirement obligations that have been accrued on the balance sheet.

Revenue recognition

The Company recognizes oil and natural gas revenues from our interests in producing wells when production is delivered to, and title has transferred to, the purchaser and to the extent the selling price is reasonably determinable. Gas-balancing arrangements are accounted for using the sales method.

Recent pronouncements

The Company has evaluated the recent accounting pronouncements through August 2012 and believes that none of them will have a material effect on the company's financial statements.

NOTE 2 – GOING CONCERN

The accompanying 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 development 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 start up costs and expenses. As a result, the Company incurred accumulated net losses from Inception (November 6, 2006) through the period ended June 30, 2012 of (\$241,805). 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 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.

Citadel Exploration, Inc.  
 (An Exploration Stage Company)  
 Notes to Consolidated Financial Statements  
 (Unaudited)

NOTE 3 – PREPAID EXPENSES

As of December 31, 2011, the Company had prepaid insurance totaling \$16,664. The prepaid insurance will be expensed on a straight line basis over the term of the insurance policy for one year. During the three months ended March 31, 2012, the Company recorded \$16,664 of insurance expenses because the Company allowed the policy to lapse.

As of June 30, 2012, the Company had prepaid insurance totaling \$16,518. The prepaid insurance will be expensed on a straight line basis over the term of the insurance policy for one year. During the three months ended June 30, 2012, the Company recorded \$2,945 of insurance expenses.

NOTE 4 – OIL AND GAS PROPERTIES

The costs capitalized in oil and gas properties as of June 30, 2012 and December 31, 2011 are as follows:

|                            | 2012      | 2011      |
|----------------------------|-----------|-----------|
| Oil and gas property lease | \$57,831  | \$61,984  |
| Exploration                | 88,338    | 143,376   |
|                            | \$146,169 | \$205,360 |

On January 31, 2009, the Company entered into an oil, gas and mineral lease with an unrelated third party. The Company has the right to develop and operate the leased premises for an initial term of three years and the lease will continue as long as the Company continues actual drilling operations and continued development. The initial minimum lease payment of \$20,661 was made upon execution of the lease and the two remaining minimum lease payments of \$20,661 were due on January 31, 2010 and 2011. Additionally, the Company is obligated to pay royalties to the unrelated third party. On oil and gas from all wells on the leased premises, the royalty is a total of 20% of the market value. The royalty payments are due on or before the last day of each month for the preceding month's activity. If the royalty payment is not made timely, the Company will owe a 10% per annum interest on the royalties due.

On February 1, 2012, the Company renegotiated its oil, gas and mineral lease with an unrelated third party for an additional minimum term of two years. The minimum lease payment is \$20,640 per year. The terms of the renegotiated lease are substantially the same as the original lease disclosed above.

On February 22, 2012, the Company sold 40% of its interest in the property disclosed above in exchange for \$350,000. The Company recorded a gain on the sale of the partial interest totaling \$267,856.

During the six months ended June 30, 2012, the Company has requested payment from Sojitz for a total of \$2,047 of exploration costs for Sojitz's portion of the costs which is recorded as other receivable as of June 30, 2012.

Citadel Exploration, Inc.  
 (An Exploration Stage Company)  
 Notes to Consolidated Financial Statements  
 (Unaudited)

## NOTE 5 – NOTES PAYABLE

Notes payable consists of the following at:

|   | June 30,<br>2012 | December<br>31, 2011 |
|---|------------------|----------------------|
| Note payable to an individual, line of credit to borrow up to \$100,000, unsecured, 10% interest, due upon demand | \$55,298         | \$55,498             |
| Note payable to an entity for the financing of insurance premiums, unsecured, 15% interest, due February 2013     | 13,381           | -                    |
|   | \$68,679         | \$55,498             |

Interest expense for the three months ended June 30, 2012 and 2011 was \$1,927 and \$0, respectively. Interest expense for the six months ended June 30, 2012 and 2011 was \$3,017 and \$0, respectively.

## NOTE 6 – NOTES PAYABLE – RELATED PARTY

Notes payable consists of the following at:

|   | June 30,<br>2012 | December<br>31, 2011 |
|---|------------------|----------------------|
| Note payable to an entity owned and controlled by an officer, director and shareholder, line of credit to borrow up to \$100,000, unsecured, 4% interest, due upon demand | \$32,240         | \$87,000             |
| Note payable to an entity owned and controlled by an officer, director and shareholder, line of credit to borrow up to \$50,000, unsecured, 4% interest, due upon demand  | 12,950           | 28,450               |
| Note payable to an entity owned and controlled by an officer, director and shareholder, line of credit to borrow up to \$50,000, unsecured, 4% interest, due upon demand  | 7,750            | 13,250               |
| Note payable to a director, unsecured, due upon demand, 0% interest   | 2,750            | 2,750                |
|   | \$55,690         | \$131,450            |

Interest expense for the three months ended June 30, 2012 and 2011 was \$580 and \$351, respectively. Interest expense for the six months ended June 30, 2012 and 2011 was \$1,726 and \$351, respectively.

Citadel Exploration, Inc.  
(An Exploration Stage Company)  
Notes to Consolidated Financial Statements  
(Unaudited)

NOTE 7 – STOCKHOLDERS' EQUITY

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

On March 2, 2011, the Company effected a 12-to-1 forward stock split of its \$0.001 par value common stock with a record date of March 22, 2011.

All shares and per share amounts have been retroactively restated to reflect the split discussed above.

During May 2012, the Company issued 42,500 shares of common stock to an investor for \$34,000 in cash received during the year ended December 31, 2011. Upon issuance of the common stock, the Company reduced the entire balance of stock payable to \$0.

NOTE 8 – WARRANTS AND OPTIONS

As of June 30, 2012, there were no warrants or options outstanding to acquire any additional shares of common stock.

NOTE 9 – RELATED PARTY TRANSACTIONS

On January 1, 2012, the Company entered into a consulting and rental agreement with an entity owned and controlled by an officer, director and shareholder. The consulting fees are fixed at \$10,000 per month and rent is up to \$25,000 per month. The agreement automatically expires on July 1, 2013 unless the parties mutually agree to extend the term. The Company will have a one-time option to extend the term of the agreement by compensating the related party with a renewal bonus of \$500,000 at which time the agreement would continue for an additional 18 months at the same terms and conditions of the agreement. During the six months ended June 30, 2012, the Company recorded consulting fees of \$60,000 and rent expense of \$62,930.

During the three months ended March 2012, the Company repaid a total of \$110,000 to reduce balances in the lines of credit due to an entity owned and controlled by an officer, director and shareholder.

During the three months ended June 2012, the Company repaid a total of \$8,750 to reduce balances in the lines of credit due to an entity owned and controlled by an officer, director and shareholder.

NOTE 10 – SUBSEQUENT EVENTS

During July 2012, the Company sold 2,000,000 shares of common stock for cash consideration of \$80,000 or \$0.04 per share. As of the date of this filing \$80,000 has been collected by the Company.

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

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 our ability to diversify our operations;
- o exploration risks such as drilling unsuccessful wells;
- o our ability to attract key personnel;
- o our ability to operate profitably;
- o our ability to efficiently and effectively finance our operations, and/or purchase orders;
- 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 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 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 deterioration in general or regional economic conditions;
- 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 subsidiaries, unless otherwise expressly stated or the context otherwise requires.





## Overview

Citadel is an energy company engaged in the exploration and development of oil and natural gas properties. Our property is located in the County of San Benito, 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 continue building value in the Company through successful exploration and development of gas and oil 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 Projects

Citadel has accepted a written invitation to participate with The Nahabedian Exploration Group LLC (NEG) and Sojitz Energy Ventures (Sojitz) in the development and extension of Landslide Oilfield. Subject to the consent of the fee mineral interest owner, permit availability, and adequate financing, Citadel will participate in a directional development well in the near term.

On January 31, 2009, our wholly-owned subsidiary, CEL, entered into an Oil and Gas Lease (“Lease”) for 688.71 acres of property with Vintage Petroleum, LLC (“Vintage”), a company owned by Occidental Petroleum (NYSE:OXY), for an initial term of three years. During February 2012, we entered into a new lease with Vintage for a period of two years.

## Other Events

On February 22, 2012, we executed a “Letter Agreement Sale of Partial Interest in Vintage Lease, Project Indian” (“Vintage Lease Agreement”) with Sojitz Energy Venture, Inc. (“Sojitz”), whereby we sold to Sojitz an undivided Forty percent (40%) interest (“Assigned Interest”) relating to the Oil, Gas, and Mineral Lease dated February 1, 2012 from Vintage Petroleum California, LLC (the “Lessor”), a Delaware Limited Liability Company and wholly owned subsidiary of Occidental Petroleum, to Citadel, as Lessee. The Vintage Lease Agreement relates to a property known as “Project Indian,” which is located in San Benito County, California, covering approximately 688.71 acres of land, for a term of Five (5) years. As consideration for the Assigned Interest, Sojitz paid Citadel the sum of Three Hundred and Fifty Thousand Dollars (\$350,000). Additionally, as part of the Vintage Lease Agreement, the parties entered into a Joint Operating Agreement (“JOA”), which includes all area under the Lease, as well as an area designated as Area of Mutual Interest or “AMI”. During the quarter ended March 31, 2012, the Company recorded a gain of the sale of the partial interest totaling \$267,856.

## 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 development stage and, accordingly, has not generated revenues from operations. As shown on the accompanying financial statements, the Company has incurred a net loss of \$241,805 for the period from inception (November 6, 2006) to June 30, 2012. 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 June 30, 2012 and June 30, 2011

During the three month period ended June 30, 2012 and 2011, we did not generate revenue.

Operating expenses totaled \$149,715 during the three month period ended June 30, 2012 as compared to total operating expense of \$117,959 in the prior three month period ended June 30, 2011. Operating expenses primarily consisted of general and administrative fees, general and administrative – related party, professional fees, professional fees- related party, and amortization in the three month period ended June 30, 2012.

General and administrative fees increased \$32,391 to \$38,715 from the three month period ended June 30, 2011 to the three month period ended June 30, 2012. This increase was primarily as a result of the insurance policy for the Company and increases for automobile expenses, phone expenses and travel expenses.

General and administrative –related party fees increased \$31,465 to \$31,465 from the three month period ended June 30, 2011 to the three month period ended June 30, 2012. This increase was primarily as a result of the placement of the Company in a corporate office.

Professional fees decreased \$62,176 to \$49,421 from the three month period ended June 30, 2011 to the three month period ended June 30, 2012. The decrease was primarily due to a decrease in legal fees.

Professional fees – related party increased \$30,000 to \$30,000 from the three month period ended June 30, 2011 to the three month period ended June 30, 2012. The increase was due to the monthly consulting fees at \$10,000 per month which was effective on January 1, 2012. The consultants were engaged due to increased activity by the Company and the initiation of a prospect generation and evaluation program.

Amortization increased \$76 to \$114 from the three month period ended June 30, 2011 to the three month period ended June 30, 2012. The increase was primarily due to amortization of the Company's website.

### Results of Operations for the Six Months Ended June 30, 2012 and June 30, 2011

During the six month period ended June 30, 2012 and 2011, we did not generate revenue.

Operating expenses, net of gains on the sale of interest in oil & gas properties and the gain on the settlement of accounts payable, totaled \$6,807 during the six month period ended June 30, 2012 as compared to total operating expense of \$119,352 in the prior six month period ended June 30, 2011. Operating expenses primarily consisted of general and administrative fees, general and administrative – related party, professional fees, professional fees- related party, and amortization in the six month period ended June 30, 2012.

General and administrative fees increased \$48,714 to \$56,431 from the six month period ended June 30, 2011 to the six month period ended June 30, 2012. This increase was primarily as a result of the insurance policy for the Company and increases for automobile expenses, phone expenses and travel expenses.

General and administrative –related party fees increased \$62,930 to \$62,930 from the six month period ended June 30, 2011 to the six month period ended June 30, 2012. This increase was primarily as a result of the placement of the Company in a corporate office.

Professional fees decreased \$15,863 to \$95,734 from the six month period ended June 30, 2011 to the six month period ended June 30, 2012. The decrease was primarily due to a decrease in legal fees.

Professional fees – related party increased \$60,000 to \$60,000 from the six month period ended June 30, 2011 to the six month period ended June 30, 2012. The increase was due to the monthly consulting fees at \$10,000 per month which was effective on January 1, 2012. The consultants were engaged due to increased activity by the Company and the initiation of a prospect generation and evaluation program.

Gain on the sale of interest in oil & gas properties increased \$267,856 during the six months ended June 30, 2012 as compared to the six month period ended June 30, 2011. The increase was due to the sale of 40% of the interest in the Indian project.

Gain on the settlement of accounts payable increased \$661 during the six months ended June 30, 2012 as compared to the six month period ended June 30, 2011. The increase was due to the settlement of accounts payable to one vendor.

Amortization increased \$191 to \$229 from the six month period ended June 30, 2011 to the six month period ended June 30, 2012. The increase was primarily due to amortization of the Company’s website.

#### Liquidity and Capital Resources

As of June 30, 2012, we had \$12,857 in cash, \$2,047 in accounts receivable, \$16,518 in prepaid expenses, and \$20,000 in prepaid stock compensation. The following table provides detailed information about our net cash flow for all financial statement periods 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 six months ended June 30, 2012 and 2011:

|   | Six Months Ended<br>June 30, |             |
|---|------------------------------|-------------|
|   | 2012                         | 2011        |
| Net cash used in operating activities               | \$(238,588 )                 | \$(90,687 ) |
| Net cash provided by (used in) investing activities | 314,779                      | (68,155 )   |
| Net cash provided by (used in) financing activities | (64,579 )                    | 158,961     |
| Net increase in Cash                                | 11,612                       | 119         |
| Cash, beginning of year                             | 1,245                        | -           |
| Cash, end of year                                   | \$12,857                     | \$119       |

### Operating activities

Net cash used in operating activities was \$238,588 for the six month period ended June 30, 2012, as compared to \$90,687 used in operating activities for the same period in 2011. The net cash used in operating activities consisted primarily of professional fees. Additionally, the most significant change was due to the gain on sale of interest in oil & gas properties and rent due to a related party.

### Investing activities

Net cash provided by investing activities was \$314,779 for the six month period ended June 30, 2012, as compared to \$68,155 used in investing activities for the same period in 2011. The net cash provided by investing activities consisted of payments for the lease payment on oil and gas property of \$20,640 and exploration costs of \$14,581. Additionally, the most significant change was due to the proceeds received totaling \$350,000 on sale of interest in oil & gas properties.

### Financing activities

Net cash used in financing activities for the six month period ended June 30, 2012 was \$62,997, as compared to \$75,267 provided by financing activities for the same period of 2011 was due to loans from related parties.

As of June 30, 2012, 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, 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 additional credit facilities. 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 continue our growth.

### 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.

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### 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 Principal Financial Officer, Christopher Whitcomb 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. Christopher Whitcomb 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 are not presently a party to any material litigation, nor to the knowledge of management is any litigation threatened against us, which may materially affect us.





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, 2011 (filed April 16, 2012) to which reference is made herein.

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

On May 7, 2012, we issued 42,500 shares of our restricted common stock to 1 accredited investor who purchased the shares in May 2011 for a total purchase price of \$34,000 all of which was paid in cash.

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.

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 June 30, 2012.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

| Exhibit No. | Description   |
|-------------|---|
| 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: August 20, 2012

By:

/S/ Armen Nahabedian

Armen Nahabedian

Chief Executive Officer

(Principal Executive Officer and duly authorized signatory)