Citadel Exploration, Inc.
Form 10-Q
August 13, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2013

¨ 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
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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 x 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 x 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 Ruble 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No x

The number of shares of Common Stock, $0.001 par value, outstanding on August 9, 2013 was 28,031,640

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CITADEL EXPLORATION, INC.
QUARTERLY PERIOD ENDED JUNE 30, 2013

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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)

	June 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash	$306,750	$112,580
Other receivable	41,829	7,253
Prepaid expenses	123,352	9,283
Total current assets	471,931	129,116
Deposits	3,150	-
Oil and gas properties	912,664	159,833
Fixed assets, net	16,370	20,299
Website, net	420	649
Total assets	$1,404,535	$309,897
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$31,220	$22,438
Accrued executive compensation	130,197	80,000
Accrued interest payable	8,316	11,217
Accrued interest payable - related party	-	3,607
Notes payable	37,757	222,527
Notes payable - related party	-	34,990
Total current liabilities	207,490	374,779
Total liabilities	207,490	374,779
Stockholders' equity (deficit):		
Common stock, $0.001 par value, 100,000,000 shares authorized, 28,031,640 and 22,613,000 shares issued and outstanding as of June 30, 2013 and December 31, 2012, respectively	28,032	22,613
Additional paid-in capital	2,669,437	740,352
Deficit accumulated during exploration stage	(1,500,424)	(827,847)
Total stockholders' equity (deficit)	1,197,045	(64,882)

Total liabilities and stockholders' equity (deficit)	$1,419,470	$309,897

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 June 30, 2013	For the three months ended June 30, 2012	For the six months ended June 30, 2013	For the six months ended June 30, 2012	Inception (November 6, 2006) to June 30, 2013
Revenue	$-	$-	$-	$-	$-
Operating expenses:					
General and administrative	74,758	38,715	130,041	56,431	326,553
General and administrative - related party	-	31,465	-	62,930	70,430
Depreciation and amortization	2,079	114	4,158	229	8,157
Professional fees	55,295	49,421	205,655	95,734	586,412
Professional fees - related party	-	30,000	-	60,000	60,000
Executive compensation	121,633	-	219,132	-	449,126
Gain on sale of interest in oil & gas properties	-	-	-	(267,856)	(267,856)
Gain on settlement of accounts payable	-	-	-	(661)	(6,161)
Total operating expenses	253,765	149,715	558,986	6,807	1,226,661
Other expenses:					
Interest expense	(1,422)	(1,653)	(113,443)	(3,017)	(260,888)
Interest expense - related party	-	(580)	(148)	(1,726)	(5,446)
Total other expenses	(1,422)	(2,233)	(113,591)	(4,743)	(266,334)
Net loss before provision for income taxes	(255,187)	(151,948)	(672,577)	(11,550)	(1,492,995)
Provision for income taxes	-	-	-	-	7,429
Net loss	$(255,187)	$(151,948)	$(672,577)	$(11,550)	$(1,500,424)
Weighted average number of common shares outstanding - basic	25,813,834	20,320,000	25,813,834	20,320,000	
Net loss per share - basic	$(0.01)	$(0.01)	$(0.03)	$(0.00)	

See Accompanying Notes to Consolidated Financial Statements.

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

	For the six months ended June 30, 2013	2012	Inception (November 6, 2006) to June 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	$(672,577)	$(11,550)	$(1,500,424)
Adjustments to reconcile net loss			
to net cash used in operating activities:			
Depreciation and amortization	4,158	229	8,157
Amortization of prepaid stock compensation	-	40,000	80,000
Amortization of debt discount	84,517	-	217,330
Gain on sale of interest in oil & gas properties	-	(267,856)	(267,856)
Non cash interest expense	22,500	-	22,500
Gain on settlement of accounts payable	-	(661)	(6,161)
Stock-based compensation expense	74,996	-	224,991
Shares issued for services	116,000	-	164,430
Changes in operating assets and liabilities:			
Increase in other receivables	(34,576)	(2,047)	(41,829)
Decrease (increase) in prepaid expenses	(61,879)	15,109	(71,164)
(Increase) in deposits	(3,150)	-	(3,150)
Increase (decrease) in accounts payable	8,782	(67,233)	66,930
Increase (decrease) in accounts payable – related party	-	50,953	-
Increase in accrued executive compensation	50,197	-	130,197
Increase (decrease) in accrued interest payable	(2,901)	2,742	8,913
Increase(decrease) in accrued interest payable - related party	(3,607)	1,726	(597)
Net cash used in operating activities	(417,540)	(238,588)	(967,733)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase oil and gas properties	(752,831)	(35,221)	(994,808)
Proceeds from sale of interest in oil & gas properties	-	350,000	350,000
Purchase of website	-	-	(1,375)
Purchase of fixed assets	-	-	(23,572)
Net cash (used in) provided by investing activities	(752,831)	314,779	(669,755)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase in overdraft from trust account	-	(286)	-
Member contributions	-	-	105,523
Member distribution	-	-	10,000
Proceeds from sale of common stock, net of costs	1,410,711	-	1,540,711
Proceeds from notes payable	-	13,381	320,261

Repayments for notes payable	(11,180)	(1,714)	(32,257)
Proceeds from notes payable - related party	-	26,040	198,013
Repayments for notes payable - related party	(34,990)	(102,000)	(198,013)
Net cash provided by (used in) financing activities	1,364,541	(64,579)	1,944,238
NET CHANGE IN CASH	194,170	11,612	306,750
CASH AT BEGINNING OF PERIOD	112,580	1,245	-
CASH AT END OF PERIOD	$306,750	$12,857	$306,750
NON-CASH INVESTING AND FINANCING ACTIVITIES			
Liabilities assumed with the acquisition of Citadel Exploration, LLC	$-	$-	$29,265
Shares issued for prepaid stock compensation	$-	$-	$80,000
Financing of insurance	$52,190	$14,963	$40,017
Forgiveness of debt due to related party	$-	$-	$50,953
Issuance of common stock for settlement of notes payable	$310,298	$-	$310,298

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, 2012 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, 2013 and 2012, 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.

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

Basic and Diluted Net Earnings (Loss) Per Share

The Company computes net income (loss) per share in accordance with ASC 260-10, which requires presentation of both basic and diluted earnings per share ("EPS") on the face of the income statement. Basic EPS is computed by dividing net income (loss) available to common shareholders (numerator) by the weighted average number of shares outstanding (denominator) during the period. Diluted EPS gives effect to all potentially dilutive common shares outstanding during the period. In computing diluted EPS, the average stock price for the period is used in determining the number of shares assumed to be purchased from the exercise of stock options or warrants. Diluted EPS excludes all potentially dilutive shares if their effect is anti-dilutive.

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

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.

Recent pronouncements
The Company has evaluated the recent accounting pronouncements through current 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 June 30, 2013 of $1,500,424. 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 June 30, 2013 and December 31, 2012 are as follows:

	2013	2012
Exploration	$912,664	$159,833

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. As of

June 30, 2013, an amount of $35,401 was owed to the Company from the joint venture partner for their portion of costs incurred on “Project Indian”.

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

On May 3, 2013, the Company executed an agreement with Sojitz Energy Ventures (operator) for participation on two exploratory wells at Rancho Grande in southern Kern County, California. Under terms of the agreement, the Company will pay 22.22% cost share for a 20% working interest. Drilling commenced on that date and the Company has paid $444,288 toward their portion for the drilling of the two wells during the second quarter of 2013. In addition, the Company elected to participate in a third well and paid $189,400 toward their portion for drilling during the second quarter of 2013. Of these total amounts, the Company has incurred $570,140 in Oil and Gas Properties.

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 drilled in 2007. The Company plans to perform recompletion operations on this well in the coming months and return it to production.

NOTE 4 – NOTES PAYABLE

Notes payable consists of the following at:

	June 30, 2013	December 31, 2012
Note payable to an individual, line of credit to borrow up to $100,000, unsecured, 10% interest, due upon demand	$-	$55,498
Note payable to an entity for the financing of insurance premiums, unsecured, 13.95% interest, due December 2013	37,757	1,746
Note payable to an individual, personally guaranteed by shares of the Company which are owned by an officer, 12% interest, due on the earlier of February 2013 or the Company raising in excess of $1,000,000	-	250,000
Debt discount	-	(84,517)
	$37,757	$222,527

NOTE 5 – NOTES PAYABLE – RELATED PARTY

Notes payable consists of the following at:

	June 30, 2013	December 31, 2012
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

Note payable to a director, unsecured, due upon demand, 0% interest	-	2,750
	$-	$34,990

The Company settled all related party notes payable during the first quarter of 2013.

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

NOTE 6 – STOCKHOLDERS' EQUITY (DEFICIT)

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 $1,423,490 or $0.34 per share, less issuance cost of $12,779.

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.

NOTE 7 – STOCK OPTION PLAN

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

As approved by the Board of Directors, on September 4, 2012, the Company granted 4,000,000 stock options to two officers of the Company at $0.20 per share for terms of seven years. Of the total stock options, 1,000,000 vested immediately and the remaining vest equally over the next 3 years at the anniversary date of the employment agreements. The total fair value of these options at the date of grant was estimated to be $599,974 and was determined using the Black-Scholes option pricing model with an expected life of 7 years, a risk free interest rate of 1.01%, a dividend yield of 0% and expected volatility of 254%. During six months ended June 30, 2013, $74,996 was recorded as a stock based compensation expense.

The following is a summary of the status of all of the Company's stock options as of June 30, 2013 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	6.18
Granted	-	$ 0.00	-
Exercised	-	$ 0.00	-

Cancelled	-	$ 0.00	-
Outstanding at June 30, 2013	4,000,000	$ 0.20	6.18
Exercisable at June 30, 2013	1,000,000	$ 0.20	6.18

NOTE 8 – SUBSEQUENT EVENTS

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. As part of this transaction, the Company retained 100% interest in the Yowlumne #2 well, which was drilled in 2007. The Company plans to perform recompletion operations on this well in the coming months and return it to production

FORWARD-LOOKING STATEMENTS

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

- exploration risks such as drilling unsuccessful wells;
- our ability to operate profitably;
- our ability to efficiently and effectively finance our operations;
- inability to achieve future sales levels or other operating results;
- inability to raise additional financing for working capital;
- inability to efficiently manage our operations;
- inability to hire or retain sufficient qualified operating field personnel;
- the inability of management to effectively implement our strategies and business plans;
- the unavailability of funds for capital expenditures and/or general working capital;
- deterioration in general or regional economic conditions;
- the fact that our accounting policies and methods are fundamental to how we report our financial condition and results of operations, and they may require management to make estimates about matters that are inherently uncertain;
- changes in U.S. GAAP or in the legal, regulatory and legislative environments in the markets in which we operate;
- adverse state or federal legislation or regulation that increases the costs of compliance, or adverse findings by a regulator with respect to existing operations;

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

References in the following discussion and throughout this quarterly report to "we", "our", "us", "Citadel", "the Company", a 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.

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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 Projects

Citadel has accepted a written invitation to participate with Black Hawk Oil Co. LLC (Blackhawk) and Sojitz Energy Ventures (Sojitz) in the South San Joaquin Valley. Sojitz and Blackhawk have collectively leased over 52,000 acres in the area under the guidance of The Nahabedian Exploration Group LLC. On May 3, 2013 Citadel signed an agreement for participation in two exploration wells in which it will pay 22.22% of the drilling cost to earn a 20% working interest. Drilling commenced on that date and the Company has paid $444,288 as their portion for the drilling of the two wells during the second quarter of 2013. In addition, the Company elected to participate in a third well and paid $189,400 as their portion for drilling during the second quarter of 2013. The wells have been completed and additional testing is required to determine the economic viability of each well. An evaluation of each prospect is ongoing.

On February 22, 2012, the Company executed a "Letter Agreement Sale of Partial Interest in Vintage Lease, Project Indian" ("Vintage Lease Agreement") with Sojitz, whereby Citadel 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 Company is obligated to pay royalties to the Lessor on oil and gas from all wells on the leased premises, and the royalty is a total of 20% of the market value. The Vintage Lease Agreement relates to a property known as "Project Indian," which is located in San Benito County, California, covering approximately 689 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". The Company recorded a gain of the sale of the partial interest totaling $267,856. The Company continues to work on obtaining permits.

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 25% interest in the lease as well as operatorship. Additionally, as part of this transaction, the Company retained a 100% interest in the Yowlumne #2 well, which was drilled in 2007. The Company plans to perform recompletion operations on this well in the coming months and return it to production.

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 $1,500,424 for the period from inception (November 6, 2006) to June 30, 2013. 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, 2013 and June 30, 2012

During the three month period ended June 30, 2013 and 2012 we did not generate revenue.

Operating expenses totaled $253,765 during the three month period ended June 30, 2013 which was an increase over the three month period ended June 30, 2012. Operating expenses consisted of general and administrative costs, amortization and depreciation, professional fees, and executive compensation. Executive compensation of $121,633 made up almost half of the quarter’s operating expenses. During the three month period ended June 30, 2012 the Company's operating expenses totaled $149,715 which was primarily made up of general and administrative costs (including related party) of $70,180 and professional fees (including related party) of $79,421.

General and administrative fees (including related party) marginally increased from $70,180 to $74,758 from the three month period ended June 30, 2012 to the three month period ended June 30, 2013.

Professional fees (including related party) decreased from $79,421 to $55,295 from the three month period ended June 30, 2012 to the three month period ended June 30, 2013. The decrease was primarily as a result of the 2012 repayment of the balances due to entities owned and controlled by an officer, director and shareholder.

Executive compensation increased from $0 to $121,633 from the three month period ended June 30, 2012 to the three month period ended June 30, 2013. 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.

Results of Operations for the Six Months Ended June 30, 2013and June 30, 2012

During the six month period ended June 30, 2013 and 2012 we did not generate revenue.

Operating expenses totaled $558,986 during the six month period ended June 30, 2013 which was an increase over the six month period ended June 30, 2012. Operating expenses consisted of general and administrative costs, amortization and depreciation, professional fees, and executive compensation. Executive compensation of $219,132 and professional fees of $205,655 made up more than 75% of the operating expenses for the first two quarters of 2013. During the six month period ended June 30, 2012 the Company's operating expenses totaled $6,807 which was primarily the result of a $267,856 gain on the sale of oil and gas properties.

General and administrative fees (including related party) increased from $119,361 to $130,041 from the six month period ended June 30, 2012 to the six month period ended June 30, 2013. This increase was primarily due to insurance, marketing and meals and entertainment expenses.

Professional fees (including related party) increased from $155,734 to $205,654 from the six month period ended June 30, 2012 to the six month period ended June 30, 2013. The increase was primarily due to services provided to the Company for accounting, consulting and legal.

Executive compensation increased from $0 to $219,132 from the six month period ended June 30, 2012 to the six month period ended June 30, 2013. 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 2013 of approximately $800,000 for Rancho Grande, Project Indian and Yowlumne. 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 June 30, 2013, we had $471,931 of current assets, of this amount $306,750 was cash. The following table provides detailed information about the net cash flow for the six months ended June 30, 2013 and June 30, 2012 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.

	Six Months Ended June 30,	
	2013	2012
Net cash used in operating activities	$(417,540)	$(238,588)
Net cash provided by (used in) investing activities	(752,831)	314,779
Net cash provided by (used in) financing activities	1,364,541	(64,579)
Net increase in cash	194,170	11,612
Cash, beginning of year	112,580	1,245
Cash, end of year	$306,750	$12,857

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Operating activities

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

Investing activities

The net cash used in investing activities consisted of payment for drilling expenses on oil and gas properties of $752,831 on the Rancho Grande, Project Indian, and Yowlumne leases.

Financing activities

As of June 30, 2013, 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.

In February 2013, the Company raised a total of $1,423,490 in cash through the sale of 4,186,000 shares of common stock at a price of $.34 per share. In addition, the Company settled all of their notes payable in the first quarter of 2013.

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.

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, 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 in 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, 2012 (filed April 1, 2013) to which reference is made herein.

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

Stock Issuances pursuant to Subscription Agreements

In February 2013, we issued 4,186,000 shares of our restricted common stock for cash consideration of $1,423,490 or $0.34 per share.

In February 2013, we issued 912,640 shares of our restricted common stock for the conversion of notes payable and interest in the amount of $332,798.

In February 2013, we issued 320,000 shares of our restricted common stock for accounting, legal and marketing services.

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, 2012 (filed April 1, 2013) 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 June 30, 2013.

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, 2012 (filed April 1, 2013) 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: August 12, 2013	By:	/S/ Armen Nahabedian Armen Nahabedian Chief Executive Officer (Principal Executive Officer and duly authorized signatory)