

Citadel Exploration, Inc.  
Form 10-Q  
November 14, 2018

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**Form 10-Q**

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

**For the quarterly period ended September 30, 2018**

**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)

<b>Nevada</b> (State or other jurisdiction of incorporation or organization)	<b>27-1550482</b> (I.R.S. Employer Identification No.)
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<b>417 31<sup>st</sup> Street, Unit A, Newport Beach, CA</b> (Address of principal executive offices)	<b>92663</b> (Zip Code)
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**(949) 612-8040**  
(Registrant's telephone number, including area code)

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 November 14, 2018 was 45,000,000 shares.

**CITADEL EXPLORATION, INC.**

**QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018**

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## PART I – FINANCIAL INFORMATION

## Item 1. Unaudited Consolidated Financial Statements.

## CITADEL EXPLORATION, INC.

## CONSOLIDATED BALANCE SHEETS

	September 30, 2018 (unaudited)	December 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash	\$ 307,381	\$ 772,103
Unbilled and joint interest billing receivables	277,497	16,540
Prepaid expenses	66,687	29,280
Product inventory	—	20,107
Total current assets	651,565	838,030
Deposits	35,100	10,100
Restricted cash	200,000	200,000
Oil and gas properties, net (successful efforts basis)		
Proved	5,923,193	5,018,086
Unproved	1,170,000	1,170,000
Fixed assets, net	71,237	82,969
Total assets	\$8,051,095	\$7,319,185
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$2,430,794	\$2,220,938
Accrued interest payable	330,585	459,416
Drilling obligation, net of discount of \$63,000 and \$126,000 as of September 30, 2018 and December 31, 2017 respectively	700,742	700,000
Notes payable, net	2,214,909	579,951
Total current liabilities	5,677,030	3,960,305
Asset retirement obligation	246,799	224,380
Related party production payment liability	300,000	300,000
Total liabilities	6,223,829	4,484,685
Stockholders' equity :		
Common stock, \$0.001 par value, 300,000,000 shares authorized , 45,000,000 and 44,449,742 shares issued and outstanding as of September 30, 2018 and December 31, 2017 respectively	45,000	44,450
Series A Preferred stock, \$20.00 par value, 500,000 shares authorized, 395,615 and 394,365 shares issued and outstanding as of September 30, 2018 and December 31,	7,912,300	7,887,300

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2017 respectively

Additional paid-in capital	6,014,828	5,691,239
Accumulated deficit	(12,144,862)	(10,788,489)
Total stockholders' equity	1,827,266	2,834,500
Total liabilities and stockholders' equity	\$8,051,095	\$7,319,185

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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CITADEL EXPLORATION, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

**(unaudited)**

	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Revenue	\$ 320,774	\$ 46,824	\$ 928,092	\$ 133,472
Operating expenses:				
Lease operating expense	202,562	94,069	676,937	216,844
General and administrative	75,204	60,632	219,843	178,821
Depreciation, depletion and amortization	135,387	8,844	407,685	26,965
Professional fees	40,951	37,738	183,237	160,855
Executive compensation	180,000	165,525	540,000	472,411
Total operating expenses	634,104	366,808	2,027,702	1,055,896
Loss from operations	(313,330 )	(319,984 )	(1,099,610 )	(922,424 )
Other expenses:				
Interest expense	(110,210 )	(198,070 )	(256,763 )	(572,636 )
Total other expenses	(110,210 )	(198,070 )	(256,763 )	(572,636 )
Loss before provision for income taxes	(423,540 )	(518,054 )	(1,356,373 )	(1,495,060 )
Income tax benefit	—	(2,188 )	—	(2,300 )
Net Loss	\$(423,540 )	\$(520,242 )	\$(1,356,373 )	\$(1,497,360 )
Series A preferred stock dividends	(199,433 )	—	(591,488 )	—
Net loss attributable to common stockholders	\$(622,973 )	\$(520,242 )	\$(1,947,861 )	\$(1,497,360 )
Weighted average number of common shares				
- outstanding - basic and diluted	45,000,000	41,348,002	44,907,286	40,692,353
Net loss per share – basic and diluted	\$(0.01 )	\$(0.01 )	\$(0.04 )	\$(0.04 )

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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CITADEL EXPLORATION, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

**(unaudited)**

	For the nine months Ended September 30,	
	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$(1,356,373	) \$(1,497,479)
Depreciation, depletion and accretion	407,684	20,989
Amortization of debt discount	151,807	—
Preferred stock dividend expense	—	406,800
Stock based compensation expense	90,051	—
Changes in operating assets and liabilities:		
Increase in unbilled and joint interest billing receivables	(260,957	) (2,065 )
Decrease (increase) in prepaid expenses	33,337	(12,414 )
Increase in deposits	(25,000	) (200 )
Increase in accrued interest payable	100,557	161,189
Increase in accounts payable and accrued payables	329,857	286,321
Net cash used in operating activities	(529,037	) (636,859 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Exploration and development of oil and gas properties	(1,383,024	) (345,117 )
Property acquisitions	—	(600,000 )
Cash received from disposal of O&G asset	131,240	—
Purchase of equipment	(6,749	) (2,215 )
Net cash used in investing activities	(1,258,533	) (947,332 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from sale of preferred stock, net of costs	25,000	875,000
Proceeds from notes payable	1,420,612	672,552
Repayments to drilling liability	(62,258	) —
Repayments of notes payable	(60,506	) (55,617 )
Net cash provided by financing activities	1,322,848	1,491,935
Net increase in cash and restricted cash	(464,722	) (92,256 )
Cash and restricted cash at beginning of year	972,103	433,793
Cash and restricted cash at end of the period	\$507,381	\$341,537
Supplemental disclosures of cash flow information:		
Cash paid for interest	3,057	—
Reclass of inventory to O&G properties	20,107	—
Income taxes paid	—	2,300
Non-cash investing and financing activities:		
Insurance premium financing	70,744	—
Shares issued to pay off bonus payable	20,000	—

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Debt Discount from senior secured credit facility	214,087	—
Asset retirement obligation	12,128	—
Non-cash addition of senior loan facility for payment of San Benito litigation	100,000	—
Accrued interest payable rolled over to senior loan facility	229,388	—
Conversion from preferred stock issuable	—	6,514,600
Issuance for preferred stock for services	—	92,708
Issuance of common stock for preferred stock interest	—	406,800

See Accompanying Notes to Unaudited Consolidated Financial Statements.



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CITADEL EXPLORATION, INC.

**Notes to Unaudited Consolidated Financial Statements**

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

Basis of presentation

The accompanying unaudited interim financial statements and notes for the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, 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 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 consolidated financial statements be read in conjunction with the financial statements of the Company for the period ended September 30, 2018 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 necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2018.

Principles of consolidation

The consolidated financial statements include the accounts of Citadel Exploration, Inc., Citadel Exploration, LLC and Citadel Kern Bluff, LLC, the Company's wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. Citadel Exploration, Inc., Citadel Exploration, LLC and Citadel Kern Bluff, 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 properties in California.

Impairment

The Company evaluates the impairment of its proved oil and natural gas properties on a field-by-field basis whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The carrying values of

proved properties are reduced to fair value when the expected undiscounted future cash flows are less than net book value. The fair values of proved properties are measured using valuation techniques consistent with the income approach, converting future cash flows to a single discounted amount. Significant inputs used to determine the fair values of proved properties include estimates of: (i) reserves; (ii) future operating and development costs; (iii) future commodity prices; and (iv) a market-based weighted average cost of capital rate. As of September 30, 2018, management believes that no impairment indicators exist.

#### Use of estimates

The preparation of consolidated 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 consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ significantly from those estimates. The accounting policies most affected by management's estimates and assumptions are the following: the reliance on estimates of proved reserves to compute the provision for depreciation, depletion and amortization and to determine the amount of any impairment of proved properties; the valuation of unproved acreage and proved crude oil and natural gas properties to determine the amount of any impairment of crude oil and natural gas properties; judgement regarding the productive status of in-progress exploratory wells to determine the amount of any provision for abandonment and estimates regarding abandonment liabilities.

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CITADEL EXPLORATION, INC.

**Notes to Unaudited Consolidated Financial Statements**

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

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.

Reclassification and comparative figures

Certain reclassifications have been made to conform the prior period's financial information to the current period's presentation. These reclassifications had no effect on previously reported net loss or accumulated deficit.

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. The Company had no cash equivalents as of September 30, 2018 and December 31, 2017.

Earnings per share

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

Disaggregation of revenue

The Company does not disaggregate revenue, as all revenue is generated from oil at one property located in California. Revenues for the three months ending September 30, 2018 and 2017 were \$320,774 and \$46,824, respectively. Revenues for the nine months ending September 30, 2018 and 2017 were \$928,092 and \$133,472, respectively.

Recent accounting pronouncements

In May 2014, the FASB issued ASC updated No. 2014-09, *Revenue from Contracts with Customers (Topic 606 (ASU 2014-09))*. Under the amendments in this update, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The amendments in this update are effective for fiscal years and interim periods within those years beginning after December 15, 2017 and supersedes any previous revenue recognition guidance. Implementation of Topic 606, which was adopted by the Company as of January 1, 2018, was done using the modified retrospective approach. Adoption of this new standard did not have an impact on the Company's balance sheet, statement of operations, statement of stockholders' equity or statement of cash flows.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash" ("ASU 2016-18"). The update is effective for years beginning December 15, 2017, including interim reporting periods within those fiscal years. Early adoption is permitted. These accounting pronouncements were adopted by the Company as of January 1, 2018. The purpose of Update 2016 -18 is to clarify guidance and presentation related to restricted cash in the Statements of Cash Flows. The amendment requires beginning-of-period and end-of- period total amounts shown on the Statements of Cash Flows to include cash and cash equivalents as well as restricted cash and restricted cash equivalents. Adoption of this new standard did not have a material impact on the Company's financial statements.

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CITADEL EXPLORATION, INC.

**Notes to Unaudited Consolidated Financial Statements****NOTE 2 – GOING CONCERN**

The accompanying unaudited 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. In addition, the Company's development activities since inception have been financially sustained through debt and equity financing. There can be no assurance that the Company will be successful to raise sufficient cash to operate over the 12 months immediately following the issuance of its financial reports. The Company incurred a net loss in the amount of \$1,356,373 for the period ended September 30, 2018. The Company has incurred net losses since entering the crude oil and natural gas exploration industry and as of September 30, 2018 has an accumulated deficit of \$12,144,862 and a working capital deficit of \$5,025,465 which raises substantial doubt about the Company's ability to continue as a going concern.

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 unaudited consolidated financial statements as of September 30, 2018, 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**

Oil and natural gas properties, buildings and equipment consist of the following:

	September 30, 2018 (unaudited )	December 31, 2017
Oil and Natural Gas:		
Proved properties	\$4,137,287	\$3,468,306
Unproved properties	1,170,000	1,170,000
Facilities	2,297,724	2,244,716
	7,605,011	6,883,022
Less oil property impairment	—	(562,030 )
Less accumulated depreciation, depletion, and amortization	(511,818 )	(132,906 )
	\$7,093,193	\$6,188,086

Total accumulated depreciation totaled \$511,818 and \$132,906, respectively, as of September 30, 2018 and December 31, 2017, respectively. For the period ending September 30, 2018 and September 30, 2017 total depletion expense totaled \$378,912 and \$12,588, respectively.

NOTE 4 – RESTRICTED CASH

Restricted cash consists of one bond totaling \$200,000 which is a blanket bond that will cover up to 50 wells. This bond was required in the normal course of business in the oil and gas industry. The bond totaling \$200,000 was purchased in August 2015 following the acquisition of the Kern Bluff Oil Field. The detail breakdown of restricted cash and cash is depicted in the Consolidated Statement of Cash Flows as follows:

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
Cash and restricted cash at end of period	\$507,381	\$341,537
Cash at end of period	\$307,381	\$141,537
Restricted cash at end of period	200,000	200,000
Cash and restricted cash, end of period	\$507,381	\$341,537

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CITADEL EXPLORATION, INC.

**Notes to Unaudited Consolidated Financial Statements****NOTE 5 – DEPOSITS**

The Company had deposits at September 30, 2018 and December 31, 2017 totaling \$35,100 and \$10,100, respectively, which pertain to: a natural gas deposit to purchase gas per contract; deposit on building rent; and a deposit to the County of San Benito for a drilling program which we are in the process of trying to have the County refund.

**NOTE 6 – NOTES PAYABLE**

Notes payable consists of the following:

	September 30, 2018 (unaudited )	December 31, 2017
Note payable to an entity for the financing of insurance premiums, unsecured 7.99% interest, due February 2019	34,847	14,548
Debt Discount on Senior Secured Facility Loan	(125,280 )	—
Senior Secured Facility Loan 10% interest; due March 31, 2019	2,250,000	—
Chandler/Lloyd Trust-Notes Payable 10% interest	—	500,000
Note payable to an entity for the financing of a company vehicle, secured; 4.95% interest, due December 2022	28,075	32,351
Note payable to an entity for the financing of a company vehicle, secured; 4.95% interest, due November 2022	27,267	33,052
Total – Notes Payable	\$2,214,909	\$579,951

In March of 2018, the Company closed on a \$3,000,000 senior secured credit facility. The facility bears 10% interest and has a one-year term. For every two dollars drawn on the facility, the investor receives one five-year warrant to purchase common stock at a price of \$0.10. The Company has drawn \$2,250,000 on the facility and issued 1,125,000 warrants. The warrants were valued using the relative fair value and the amount recorded as a debt discount amortized over the life of the line of credit using effective interest method. Future drawdowns are at the discretion of the lender. The senior secured facility is secured by a deed of trust on the Kern Bluff Oil Field. Proceeds from the first draw were used to retire the previous bridge loan and accrued interest. The balance was used for general corporate purposes, including the drilling of a well.

NOTE 7 – STOCKHOLDERS' EQUITY

The Company is authorized to issue 300,000,000 shares of its \$0.001 par value common stock. The Company is authorized to issue 500,000 shares of Series A Convertible Participating Preferred Stock.

For the nine-months ended September 30, 2018, the Company i