

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

Form 10-K

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

For the fiscal year ended December 31, 2016

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

For the Transition Period from _____ to _____

Commission file number 000-54369



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, CA 92663**

(Address of principal executive offices)

(949) 612-8040

(Registrant's telephone number, including area code)

Securities registered pursuant to
Section 12(b) of the Act:

None

Securities registered pursuant to
Section 12(g) of the Act:

Common Stock, \$0.001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has 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 Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 the 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)

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 aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of December 30, 2016 (the last business day of the registrant's most recently completed fourth fiscal quarter) was \$9,042,220 based on a share value of \$0.23. The number of shares of Common Stock, \$0.001 par value, outstanding on March 31, 2017 was 41,348,002 shares.

DOCUMENTS INCORPORATED BY REFERENCE: None.

**CITADEL EXPLORATION, INC.
FOR THE FISCAL YEAR ENDED
DECEMBER 31, 2016**

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

PART I	Page
Item 1. Business	1
Item 1A. Risk Factors	16
Item 1B. Unresolved Staff Comments	25
Item 2. Properties	1
Item 3. Legal Proceedings	25
Item 4. Mine Safety Disclosures	26
 PART II	
Item 5. Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities	27
Item 6. Selected Financial Data	29
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	29
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	34
Item 8. Consolidated Financial Statements and Supplementary Data	35
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	35
Item 9A. Control and Procedures	36
Item 9B. Other Information	36
 PART III	
Item 10. Directors, Executive Officers and Corporate Governance	37
Item 11. Executive Compensation	41
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	43
Item 13. Certain Relationships and Related Transactions, and Director Independence	44
Item 14. Principal Accounting Fees and Services	45
 PART IV	
Item 15. Exhibits, Consolidated Financial Statement Schedules	46

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K 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:

- our ability to diversify our operations;
- exploration risks such as drilling unsuccessful wells;
- our ability to attract key personnel;
- our ability to operate profitably;
- our ability to efficiently and effectively finance our operations, and/or purchase orders;
- inability to achieve future sales levels or other operating results;
- inability to raise additional financing for working capital;
- inability to efficiently manage our operations;
- the inability of management to effectively implement our strategies and business plans;
- the unavailability of funds for capital expenditures and/or general working capital;
- 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;
- deterioration in general or regional economic conditions;
- 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. Forward-looking statements may appear throughout this report, including without limitation, the following sections: Item 1 “Business,” Item 1A “Risk Factors,” and Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements generally can be identified by words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will be,” “will continue,” “will likely result,” and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which 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 Annual Report on Form 10-K, and in particular, the risks discussed under the caption “Risk Factors” in Item 1A and those discussed in other documents we file with the Securities and Exchange Commission (SEC). We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Throughout this Annual Report references to “we”, “our”, “us”, “Citadel”, “COIL”, “the Company”, and similar terms include to Citadel Exploration, Inc. and its subsidiaries, unless the context indicates otherwise.

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 consolidated financial statements, at no charge upon receipt of a written request to us at Citadel Exploration, Inc., 417 31st Street Unit A, Newport Beach, California 92663.

INDUSTRY AND MARKET DATA

The market data and certain other statistical information used throughout this report are based on independent industry publications, government publications, reports by market research firms or other published independent sources. In addition, some data are based on our good faith estimates.

PART I

ITEM 1. BUSINESS AND PROPERTIES

Business Development

Citadel Exploration, Inc. (“Citadel”) was formed as a Nevada corporation in December 2009. On March 2, 2011, Citadel changed its name from Subprime Advantage, Inc. to Citadel Exploration, Inc. Effective May 3, 2011, Citadel completed the acquisition of the Indian Shallow Oil Development Project, located in the Bitterwater sub-basin of the Salinas Basin in California, consisting of 689 acres of leased property from Vintage Petroleum, LLC (Vintage), then a division of Occidental Petroleum (NYSE: OXY), through the acquisition of 100% of the outstanding membership interest of Citadel Exploration, LLC, a California Limited Liability Company (“CEL”) pursuant to the Membership Purchase Agreement and Plan of Reorganization (“Membership Purchase Agreement”).

As a result of our acquisition of CEL, we have a broad portfolio of capital investment opportunities that arise from CEL’s extensive knowledge of the geology and the history of oil and gas exploration and development in California as well as long-term presence and familiarity and relationships with other companies engaged in the oil and gas industry in California.

Business of Citadel

Citadel is an energy company engaged in the exploration and development of oil and natural gas properties. Our primary focus is on properties located in the San Joaquin Basin 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 acquisition of gas and oil leases with significant upside potential, successful exploration and exploitation and the efficient development of these assets.

Our Projects

KERN BLUFF OIL FIELD

In July of 2015, Citadel purchased approximately 1,100 acres encompassing the Kern Bluff Oil Field in Kern County, California for \$2,000,000 in cash and 6,000,000 shares of its common stock valued at \$480,000. The seller also retained a royalty that varies on a lease by lease basis; Citadel has 100% working interest in the field with an 80% net revenue interest. In 2015, Citadel re-entered 7 idle well bores, and began to return those wells to production. Production as of December 31, 2016 was approximately 30 barrels of oil per day (BOPD). The field had 29 idle well bores upon acquisition, Citadel plans to re-enter each of these well bores in 2017 and 2018 and attempt to return them to production.

Table of Contents

In December of 2015, Citadel shifted its CAPEX focus to remediation of the existing acquired facilities. At the time of purchase, the oil at Kern Bluff was being processed by temporary facilities installed by the previous owner. As production increased it quickly became apparent that these facilities were not capable of processing the additional volumes of oil and water being produced. The existing permanent facilities were built in the 1970's by Gulf Oil and require extensive remediation including new pipe, valves, flanges and tank repair. To facilitate the remediation, Citadel elected to shut down the eight producing wells in early January of 2016. Citadel completed the facility remediation in July of 2016, the facilities are estimated to have production capability of 500 BOPD. Citadel returned 8 wells to production in the third quarter of 2016 and drilled three new wells.

PROJECT YOWLUMNE

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

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

In December of 2014, Citadel began a work-over on the Yowlumne #2-26 well including installation of a new pump in February of 2015. The well has been producing approximately 20- 25 barrels per day (32 degree API quality) since March of 2015. In June the well's pump had a mechanical issue, the company performed well maintenance operations on the #2-26 well in August, which returned the well to production at approximately 20-25 barrels per day. During December of 2015, extremely cold weather forced the shut-down of the #2-26 well. Low oil prices coupled with high water disposal costs in 2016 prevented Citadel from turning the well back on. With oil prices rebounding and stabilizing in the \$50.00 per barrel range, Citadel plans to return the well to production in the second or third quarter of 2017. Citadel is in the final stages of the CEQA process to permit two additional exploration wells on the Yowlumne acreage. Recent regulatory changes, including SB4 the State of California's bill on fracking have delayed the final approval of our CEQA application. As such we do not expect to have these prospects permitted until the end of 2017, at which time we will determine when to drill. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 15,000 feet. Citadel currently has a 75% working interest in these exploration prospects and is the operator.

Table of Contents

PROJECT INDIAN

Project Indian is located in the Bitterwater sub-basin of the Salinas Basin, north of the giant San Ardo Field. Citadel currently owns a 100% working interest at Project Indian. In July of 2014 Citadel ended its prior joint venture with Sojitz Energy Ventures. There is a 20% royalty on the property owned by Vintage Petroleum which is now a part of California Resources Corporation (CRC). CRC is now the mineral owner at Project Indian.

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

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

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

Based on the uncertainty of the project, management impaired \$1,420,574 of value on Project Indian in the fourth quarter of 2014. The Company maintains its lease rights, takings claims, and no waiver of any right is intended by taking the foregoing impairment. Any action taken by the Company with respect to Project Indian in the near future, if any, will likely only be taken to preserve or advance the Company’s aforementioned legal rights and interests.

Proved Reserves

Evaluation and Review of Proved Reserves: Our proved reserve estimates as of December 31, 2016 were prepared based on reports by MHA Petroleum Consultants (“MHA”). MHA does not own an interest in any of our properties, nor is it employed by us on a contingent basis. Within MHA, the technical person primarily responsible for preparing the estimates set forth in the MHA letter dated March 22, 2017, filed as an exhibit to this Annual Report, was Mr. Alan Burzlaff. Mr. Burzlaff, Managing Partner at MHA and a Licensed Professional Engineer in the State of California, has been practicing consulting petroleum engineering at MHA since 2009 and has over 36 years of prior industry experience.

Table of Contents

We do not maintain an internal staff of petroleum engineers or geoscience professionals although our management team did meet with our independent reserve engineers to provide as accurate data as reasonable for use in calculating our proved reserves relating to our assets.

Estimation of Proved Reserves: Under SEC rules, proved reserves are those quantities of oil and natural gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs and under existing economic conditions, operating methods and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. If deterministic methods are used, the SEC has defined reasonable certainty for proved reserves as a “high degree of confidence that the quantities will be recovered.” All of our proved reserves as of December 31, 2016 were estimated using a deterministic method. The estimation of reserves involves two distinct determinations. The first determination results in the estimation of the quantities of recoverable oil and natural gas and the second determination results in the estimation of the uncertainty associated with those estimated quantities in accordance with the definitions established under SEC rules. The process of estimating the quantities of recoverable oil and natural gas reserves relies on the use of certain generally accepted analytical procedures. These analytical procedures fall into four broad categories or methods: (1) production performance-based methods; (2) material balance-based methods; (3) volumetric-based methods; and (4) analogy. These methods may be used singularly or in combination by the reserve evaluator in the process of estimating the quantities of reserves. As our Kern Bluff property is new to the Company in 2015 and we had limited current production history, our reserves were forecast using a combination of production performance and analogy to similar production, both of which are considered to provide a relatively high degree of accuracy.

To estimate economically recoverable proved reserves and related future net cash flows, MHA considered many factors and assumptions, including the use of reservoir parameters derived from geological and engineering data which cannot be measured directly, economic criteria based on current costs and the SEC pricing requirements and forecasts of future production rates. The current pricing environment could impact future economics.

Under SEC rules, reasonable certainty can be established using techniques that have been proven effective by actual production from projects in the same reservoir or an analogous reservoir or by other evidence using reliable technology that establishes reasonable certainty. Reliable technology is a grouping of one or more technologies (including computational methods) that has been field tested and has been demonstrated to provide reasonably certain results with consistency and repeatability in the formation being evaluated or in an analogous formation. To establish reasonable certainty with respect to our estimated proved reserves, the technologies and economic data used in the estimation of our proved reserves have been demonstrated to yield results with consistency and repeatability, and include production and well test data, downhole completion information, geologic data, electrical logs, radioactivity logs, core analyses, current or estimated well cost and operating expense data.

Table of Contents

Summary of Oil, NGLs, and Natural Gas Reserves. The following table presents our estimated net proved oil, NGLs, and natural gas reserves as of the periods indicated:

	December 31,	
	2016	2015
Proved developed reserves:		
Oil (MBbls)	220	358
Natural gas (MMcf)	--	--
Combined (MBoe)(1)	220	358
Proved undeveloped reserves:		
Oil (MBbls)	920	1,056
Natural gas (MMcf)	--	--
Combined (MBoe)(1)	920	1,056
Proved reserves:		
Oil (MBbls)	1,160	1,414
Natural gas (MMcf)	--	--
Combined (MBoe)(1)	1,160	1,414

- (1) One Boe is equal to six Mcf of natural gas or one Bbl of oil or NGLs based on an approximate energy equivalency. This is an energy content correlation and does not reflect a value or price relationship between the commodities.

Table of Contents

Reserve engineering is and must be recognized as a subjective process of estimating volumes of economically recoverable oil and natural gas that cannot be measured in an exact manner. The accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation. As a result, the estimates of different engineers often vary. In addition, the results of drilling, testing and production may justify revisions of such estimates. Accordingly, reserve estimates often differ from the quantities of oil and natural gas that are ultimately recovered. Estimates of economically recoverable oil and natural gas and of future net revenues are based on a number of variables and assumptions, all of which may vary from actual results, including geologic interpretation, prices and future production rates and costs. Please read “Item 1A. Risk Factors.”

Additional information regarding our proved reserves can be found in the notes to our consolidated and combined financial statements included elsewhere in this Annual Report and the proved reserve report as of December 31, 2016, which is included as an exhibit to this Annual Report.

Proved Undeveloped Reserves (PUDs)

As of December 31, 2016, our proved undeveloped reserves were composed of 920 MBbls of oil, 0 MMcf of natural gas, for a total of 920 MBoe. PUDs will be converted from undeveloped to developed as the applicable wells are drilled and begin production.

The following table summarizes our changes in PUDs during the year ended December 31, 2016 (in MBoe):

Balance, December 31, 2015	1,056
Purchases of reserves	0
Extensions and discoveries	0
Revisions of previous estimates	(136)
Transfers to proved developed	0
Balance, December 31, 2016	<u>920</u>

Table of Contents

Estimated future development costs relating to the development of PUDs at December 31, 2016 were projected to be approximately \$0.3 million in the year ended December 31, 2016, \$5.9 million in 2017, \$1.7 million in 2018, \$0.8 million in 2019, and \$0.3 million in future periods. As we continue to develop our properties and have more well production and completion data, we believe we will continue to realize cost savings and experience lower relative drilling and completion costs as we convert PUDs into proved developed reserves in upcoming years. All of our PUD drilling locations are scheduled to be drilled within five years of their initial booking.

As of December 31, 2016, 160 MBbls of our total proved reserves were classified as proved developed non-producing.

Oil and Natural Gas Industry Overview

Oil and natural gas prices have been extremely volatile over the past twelve months and are currently at five year lows. Based on worldwide supply and demand projections and the potential for instability in areas that currently provide a large proportion of the world's petroleum, we believe that prices are likely to remain volatile for the foreseeable future. We believe that this presents both a tremendous challenge and opportunity for our Company to grow quickly. We have assembled an experienced senior team of professionals to evaluate, acquire and manage available prospects. The experience of this team and its ability to quickly and accurately evaluate prospects and subsequently apply modern exploration, development and production techniques should be key to our Company's success. A number of factors, including high product prices, the ease and availability of capital, and the influx of that capital into the oil and natural gas sector has resulted in tremendous competition for prospects, people, equipment and services in recent years. We believe that our planned ability to quickly and accurately assess opportunities worth pursuing, to negotiate the best possible terms and to attract the people, equipment and services required to finance and effect the projects should constitute a competitive advantage. Our goal is to grow our Company and increase stockholder value in a favorable petroleum pricing environment. We believe a focus on oil and gas will result in success and growth through added reserves and cash flow which will, in turn, provide a base for further growth and increases in stockholder value.

Our Business Strategy

Our principal strategy has been 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. Our strategy is now equally focused on pursuing by-passed oil opportunities that contain significant potential reserves. 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. The principal elements of our business strategy are:

Table of Contents

- *Develop Our Existing Properties.* We intend to create reserve and production growth from our drilling locations we have identified on our property. The expected ultimate recovery and production rates of our properties, are anticipated to yield long-term profitability.
- *Maximize Operational Control.* We seek to operate our properties and maintain a substantial working interest. We believe the ability to control our drilling inventory will provide us with the opportunity to more efficiently allocate capital, manage resources, control operating and development costs, and utilize our experience and knowledge of oilfield technologies.
- *Pursue Selective Acquisitions and Joint Ventures.* We believe we are well-positioned to pursue selected acquisitions, subject to availability of capital, from the fragmented and capital-constrained owners of mineral rights throughout California.
- *Reduce Unit Costs Through Economies of Scale and Efficient Operations.* As we increase our oil production and develop our existing property, we expect that our unit cost structure will benefit from economies of scale. In particular, we anticipate reducing unit costs by greater utilization of our existing infrastructure over a larger number of wells.

We are continually evaluating oil and natural gas opportunities in California and are also in various stages of discussions with potential joint venture (“JV”) partners who may contribute capital to develop leases we currently own or would acquire for the JV. This economic strategy is anticipated to allow us to utilize our own financial assets toward the growth of our leased acreage holdings, pursue the acquisition of strategic oil and natural gas producing properties or companies and generally expand our existing operations while further diversifying risk. Subject to availability of capital, we plan to continue to bring potential acquisition and JV opportunities to various financial partners for evaluation and funding options.

Our future financial results will continue to depend on: (i) our ability to source and screen potential projects; (ii) our ability to discover commercial quantities of natural gas and oil; (iii) the market price for oil and natural gas; and (iv) our ability to fully implement our exploration, work-over and development program, which is in part 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 natural 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 at terms favorable to us to increase our currently limited capital resources. For a detailed description of these and other factors that could materially impact actual results, please see “Risk Factors” in this report.

Competition

The oil and natural gas industry is intensely competitive. We compete with numerous individuals and companies, including many major oil and natural gas companies, which have substantially greater technical, financial and operational resources and staff. Accordingly, there is a high degree of competition for desirable oil and natural gas leases, suitable properties for drilling operations and necessary drilling equipment, as well as for access to funds.

Table of Contents

Governmental Regulations

Regulation of Oil and Natural Gas Production. Our oil and natural gas exploration, production and related operations, when developed, are subject to extensive rules and regulations promulgated by federal, state, tribal and local authorities and agencies. For example, some states in which we may operate, including California, require permits for drilling operations, drilling bonds and reports concerning operations and impose other requirements relating to the exploration and production of oil and natural gas. Such states may also have statutes or regulations addressing conservation matters, including provisions for the unitization or pooling of oil and natural gas properties, the establishment of maximum rates of production from wells, well stimulation techniques such as hydraulic fracturing, acid matrix stimulation, cyclic steam injection and the regulation of spacing, plugging and abandonment of such wells. Failure to comply with any such rules and regulations can result in substantial penalties. Moreover, such states may place burdens from previous operations on current lease owners, and the burdens could be significant. The regulatory burden on the oil and natural gas industry will most likely increase our cost of doing business and may affect our profitability. Although we believe we are currently in substantial compliance with all applicable laws and regulations, because such rules and regulations are frequently amended or reinterpreted, we are unable to predict the future cost or impact of complying with such laws. Significant expenditures may be required to comply with governmental laws and regulations and may have a material adverse effect on our financial condition and results of operations.

Federal Regulation of Natural Gas. The Federal Energy Regulatory Commission (“FERC”) regulates interstate natural gas transportation rates and service conditions, which may affect the marketing of natural gas produced by us, as well as the revenues that may be received by us for sales of such production. Since the mid-1980’s, FERC has issued a series of orders, culminating in Order Nos. 636, 636-A and 636-B (“Order 636”), that have significantly altered the marketing and transportation of natural gas. Order 636 mandated a fundamental restructuring of interstate pipeline sales and transportation service, including the unbundling by interstate pipelines of the sale, transportation, storage and other components of the city-gate sales services such pipelines previously performed. One of FERC’s purposes in issuing the order was to increase competition within all phases of the natural gas industry. The United States Court of Appeals for the District of Columbia Circuit largely upheld Order 636 and the Supreme Court has declined to hear the appeal from that decision. Generally, Order 636 has eliminated or substantially reduced the interstate pipelines’ traditional role as wholesalers of natural gas in favor of providing only storage and transportation service, and has substantially increased competition and volatility in natural gas markets.

The price we may receive from the sale of oil and natural gas liquids will be affected by the cost of transporting products to markets. Effective September 28, 1995, FERC implemented regulations establishing an indexing system for transportation rates for oil pipelines, which, generally, would index such rates to inflation, subject to certain conditions and limitations. We are not able to predict with certainty the effect, if any, of these regulations on our intended operations. However, the regulations may increase transportation costs or reduce well head prices for oil and natural gas liquids.

Table of Contents

Environmental Matters

Our operations and properties are subject to extensive and changing federal, state and local laws and regulations relating to environmental protection, including the generation, storage, handling, emission, transportation and discharge of materials into the environment, and relating to safety and health. The recent trend in environmental legislation and regulation generally is toward stricter standards, and this trend will likely continue.

These laws and regulations may:

- require the acquisition of a permit or other authorization before construction or drilling commences and for certain other activities;
- limit or prohibit construction, drilling and other activities on certain lands lying within wilderness and other protected areas; and
- impose substantial liabilities for pollution resulting from its operations, or due to previous operations conducted on any leased lands.

The permits required for our operations may be subject to revocation, modification and renewal by issuing authorities. Governmental authorities have the power to enforce their regulations, and violations are subject to fines or injunctions, or both. In the opinion of management, we are in substantial compliance with current applicable environmental laws and regulations, and have no material commitments for capital expenditures to comply with existing environmental requirements. Nevertheless, changes in existing environmental laws and regulations or in interpretations thereof could have a significant impact on us, as well as the oil and natural gas industry in general.

The Comprehensive Environmental, Response, Compensation, and Liability Act, as amended (“CERCLA”), and comparable state statutes impose strict, joint and several liability on owners and operators of sites and on persons who disposed of or arranged for the disposal of “hazardous substances” found at such sites. It is not uncommon for the neighboring land owners and other third parties to file claims for personal injury and property damage allegedly caused by the hazardous substances released into the environment. The Federal Resource Conservation and Recovery Act, as amended (“RCRA”), and comparable state statutes govern the disposal of “solid waste” and “hazardous waste” and authorize the imposition of substantial fines and penalties for noncompliance. Although CERCLA currently excludes petroleum from its definition of “hazardous substance,” state laws affecting our operations may impose clean-up liability relating to petroleum and petroleum related products. In addition, although RCRA classifies certain oil field wastes as “non-hazardous,” such exploration and production wastes could be reclassified as hazardous wastes thereby making such wastes subject to more stringent handling and disposal requirements.

Table of Contents

The Federal Water Pollution Control Act of 1972, as amended (“Clean Water Act”), and analogous state laws impose restrictions and controls on the discharge of pollutants into federal and state waters. These laws also regulate the discharge of storm water in process areas. Pursuant to these laws and regulations, we are required to obtain and maintain approvals or permits for the discharge of wastewater and storm water and develop and implement spill prevention, control and countermeasure plans, also referred to as “SPCC plans,” in connection with on-site storage of greater than threshold quantities of oil. The EPA issued revised SPCC rules in July 2002 whereby SPCC plans are subject to more rigorous review and certification procedures. We believe that our operations are in substantial compliance with applicable Clean Water Act and analogous state requirements, including those relating to wastewater and storm water discharges and SPCC plans.

The Endangered Species Act, as amended (“ESA”), seeks to ensure that activities do not jeopardize endangered or threatened animal, fish and plant species, nor destroy or modify the critical habitat of such species. Under ESA, exploration and production operations, as well as actions by federal agencies, may not significantly impair or jeopardize the species or its habitat. ESA provides for criminal penalties for willful violations of the Act. Other statutes that provide protection to animal and plant species and that may apply to our operations include, but are not necessarily limited to, the Fish and Wildlife Coordination Act, the Fishery Conservation and Management Act, the Migratory Bird Treaty Act and the National Historic Preservation Act. Although we believe that our operations will be in substantial compliance with such statutes, any change in these statutes or any reclassification of a species as endangered could subject us to significant expenses to modify our operations or could force us to discontinue certain operations altogether.

Personnel

We currently have three full-time employees, our Chief Executive Officer, our Chief Financial Officer and our General Counsel. As production and drilling activities increase or decrease, we may have to adjust our technical, operational and administrative personnel as appropriate. We are using and will continue to use independent consultants and contractors to perform various professional services, particularly in the area of land services, legal services, reservoir engineering, geology drilling, water hauling, pipeline construction, well design, well-site monitoring and surveillance, permitting and environmental assessment. We believe that this use of third-party service providers may enhance our ability to contain operating and general expenses, and capital costs.

Table of Contents

Glossary of Terms

Term	Definition
API Gravity	Is a measure of how heavy or light a petroleum liquid is compared to water. If its API gravity is greater than 10, it is lighter and floats on water; if less than 10, it is heavier and sinks.
Barrel	In the energy industry, a barrel is a unit of volume measurement used for petroleum and is equivalent to 42 U.S. gallons measured at 60 ° Fahrenheit.
Basin	A depressed area where sediments have accumulated during geologic time and considered to be prospective for oil and gas deposits.
Blowout	An uncontrolled flow of oil, gas, water or mud from a wellbore caused when drilling activity penetrates a rock layer with natural pressures greater than the drilling mud in the borehole.
Completion / Completing	A well made ready to produce oil or natural gas. Completion involves cleaning out the well, running and cementing steel casing in the hole, adding permanent surface control equipment, and perforating the casing so oil or gas can flow into the well and be brought to the surface.
Desorb	The release of materials (e.g., gas molecules) from being adsorbed onto a surface. The opposite of adsorb.
Development	The phase in which a proven oil or gas field is brought into production by drilling production (development) wells.
Division order	A contract for the sale of oil or gas, by the holder of a revenue interest in a well or property, to the purchaser (often a pipeline transmission company).
Drilling	The using of a rig and crew for the drilling, suspension, production testing, capping, plugging and abandoning, deepening, plugging back, sidetracking, re-drilling or reconditioning of a well. Contrast to "Completion" definition.
Drilling logs	Recorded observations made of rock chips cut from the formation by the drill bit, and brought to the surface with the mud, as well as rate of penetration of the drill bit through rock formations. Used by geologists to obtain formation data.

Table of Contents

Exploration	The phase of operations which covers the search for oil or gas by carrying out detailed geological and geophysical surveys followed up where appropriate by exploratory drilling. Compare to "Development" phase.
Farm out	Assignment or partial assignment of an oil and gas lease from one lessee to another lessee.
Gathering line / system	A pipeline that transports oil or gas from a central point of production to a transmission line or mainline.
Gross acre	An acre in which a working interest is owned. The number of gross acres is the total number of acres in which a working interest is owned.
Gross well	A well in which a working interest is owned. The number of gross wells is the total number of wells in which a working interest is owned.
Held-By-Production (HBP)	Refers to an oil and gas property under lease, in which the lease continues to be in force, because of production from the property.
Land services	Services performed by an oil and gas company or agent, or landman, who negotiates oil and gas leases with mineral owners, cures title defects, and negotiates with other companies on agreements concerning the lease.
Logging (electric logging)	Process of lowering sensors into a wellbore to acquire downhole recordings that indicate a well's rock formation characteristics and indications of hydrocarbons.
Methane	An organic chemical compound of hydrogen and carbon (i.e., hydrocarbon), with the simplest molecular structure (CH ₄).
Mineral Lease	A legal instrument executed by a mineral owner granting exclusive right to another to explore, drill, and produce oil and gas from a piece of land.
Natural gas quality	The value of natural gas is calculated by its BTU content. A cubic foot of natural gas on the average gives off 1000 BTU, but the range of values is between 500 and 1500 BTU. Energy content of natural gas is variable and depends on its accumulations which are influenced by the amount and types of energy gases they contain: the more non-combustible gases in a natural gas, the lower the Btu value.

Table of Contents

Net acre	A net acre is deemed to exist when the sum of fractional working interests owned in gross acres equals one. The number of net acres is the sum of fractional working interests owned in gross acres expressed as whole numbers and fractions thereof.
Net well	A net well is deemed to exist when the sum of fractional working interests owned in gross wells equals one. The number of net wells is the sum of fractional working interests owned in gross wells expressed as whole numbers and fractions thereof.
Operator	A person, acting for himself or as an agent for others and designated to the state authorities as the one who has the primary responsibility for complying with its rules and regulations in any and all acts subject to the jurisdiction of the state.
Permeability	The property of a rock formation which quantifies the flow of a fluid through the pore spaces and into the wellbore.
Pooled, Pooled Unit	A term frequently used interchangeably with "Unitization" but more properly used to denominate the bringing together of small tracts sufficient for the granting of a well permit under applicable spacing rules.
Proved Reserves	<p>Estimated quantities of crude oil, natural gas, condensate, or other hydrocarbons that geological and engineering data demonstrate with reasonable certainty to be commercially recoverable in the future from known reservoirs under existing conditions using established operating procedures and under current governmental regulations.</p> <p>Further definitions of oil and gas reserves, as defined by the SEC, can be found in Rule 4-10(a)(2)(i)-(iii) and Rule 4-10(a)(3) and (4). These Rules are available at the SEC's website; http://www.sec.gov/divisions/corpfin/ecfrlinks.shtml</p>
Re-completion	Completion of an existing well for production from one formation or reservoir to another formation or reservoir that exists behind casing of the same well.
Reserves	Generally the amount of oil or gas in a particular reservoir that is available for production.
Reservoir	The underground rock formation where oil and gas has accumulated. It consists of a porous rock to hold the oil or gas, and a cap rock that prevents its escape.
Reservoir Pressure	The pressure at the face of the producing formation when the well is shut-in. It equals the shut in pressure at the wellhead plus the weight of the column of oil in the hole.

Table of Contents

Shut-in well	A well which is capable of producing but is not presently producing. Reasons for a well-being shut-in may be lack of equipment, market or other.
Stratigraphic Trap	A variety of sealed geologic containers capable of retaining hydrocarbons, formed by changes in rock type or pinch-outs, unconformities, or sedimentary features.
Structural Trap	A variety of sealed geologic structures capable of retaining hydrocarbons, such as a faults or a folds.
Undeveloped acreage	Leased acreage which has yet to be drilled on to test the potential for hydrocarbons.
Unitize, Unitization	Joint operations to maximize produced hydrocarbon recovery among separate operators within a common reservoir.
Working Interest	The right granted to the lessee of a property to explore for and to produce and own oil, gas, or other minerals. The working interest owners bear the exploration, development, and operating costs on either a cash, penalty, or carried basis.

Table of Contents

ITEM 1A. RISK FACTORS

RISKS ASSOCIATED WITH OIL AND GAS OPERATIONS

Drilling wells is speculative, often involving significant costs that may be more than our estimates, and may not result in any addition to our production or reserves. Any material inaccuracies in drilling costs, estimates or underlying assumptions will materially affect our business.

Developing and exploring for natural gas and oil involves a high degree of operational and financial risk, which precludes definitive statements as to the time required and costs involved in reaching certain objectives. The budgeted costs of drilling, completing and operating wells are often exceeded and can increase significantly when drilling costs rise due to a tightening in the supply of various types of oilfield equipment and related services. Drilling may be unsuccessful for many reasons, including title problems, weather, cost overruns, equipment shortages and mechanical difficulties. Moreover, the successful drilling of a natural gas or oil well does not ensure a profit on investment. Exploratory wells bear a much greater risk of loss than development wells. A variety of factors, both geological and market-related, can cause a well to become uneconomical or only marginally economic. Our initial drilling and development sites, and any potential additional sites that may be developed, require significant additional exploration and development, regulatory approval and commitments of resources prior to commercial development. Any success that we may have with these wells or any future drilling operations will most likely not be indicative of our current or future drilling success rate, particularly, because we intend to emphasize on exploratory drilling. If our actual drilling and development costs are significantly more than our estimated costs, we may not be able to continue our business operations as proposed and would be forced to modify our plan of operation.

Development of our reserves, when established, may not occur as scheduled and the actual results may not be as anticipated. Drilling activity may result in downward adjustments in reserves or higher than anticipated costs. Our estimates will be based on various assumptions, including assumptions required by the Securities and Exchange Commission relating to natural gas and oil prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. The process of estimating our natural gas and oil reserves is anticipated to be extremely complex, and will require significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data for each reservoir. Due to our inexperience in the oil and gas industry, our estimates may not be reliable enough to allow us to be successful in our intended business operations. Our actual production, revenues, taxes, development expenditures and operating expenses will likely vary from those anticipated. These variances may be material.

Gas and Oil prices are volatile. This volatility may occur in the future, causing negative change in cash flows which may result in our inability to cover our capital expenditures.

Our future revenues, profitability, future growth and the carrying value of our properties is anticipated to depend substantially on the prices we may realize for our natural gas and oil production.

Table of Contents

Our realized prices may also affect the amount of cash flow available for capital expenditures and our ability to borrow and raise additional capital.

Natural gas and oil prices are subject to wide fluctuations in response to relatively minor changes in or perceptions regarding supply and demand. Historically, the markets for natural gas and oil have been volatile, and they are likely to continue to be volatile in the future. For example, oil prices declined significantly in late 2014 and 2015 and have remained lower for an extended period of time. Among the factors that can cause this volatility are:

- worldwide or regional demand for energy, which is affected by economic conditions;
- the domestic and foreign supply of natural gas and oil;
- weather conditions;
- domestic and foreign governmental regulations;
- political conditions in natural gas and oil producing regions;
- the ability of members of the Organization of Petroleum Exporting Countries to agree upon and maintain oil prices and production levels; and
- the price and availability of other fuels.
- President Donald J. Trump

It is impossible to predict natural gas and oil price movements with certainty. Lower natural gas and oil prices may not only decrease our future revenues on a per unit basis but also may reduce the amount of natural gas and oil that we can produce economically. A substantial or extended decline in natural gas and oil prices may materially and adversely affect our future business enough to force us to cease our business operations. In addition, our financial condition, results of operations, liquidity and ability to finance planned capital expenditures will also suffer in such a price decline. Further, natural gas and oil prices do not necessarily move together.

We may incur substantial write-downs of the carrying value of our gas and oil properties, which would adversely impact our earnings.

We periodically review the carrying value of our gas and oil properties under the successful effort method accounting rules of the Securities and Exchange Commission. Under these rules, capitalized costs of proved gas and oil properties may not exceed the present value of estimated future net revenues from proved reserves, discounted at an annual rate of 10%. Application of this “ceiling” test requires pricing future revenue at the un-escalated prices in effect as of the end of each fiscal quarter and requires a write-down for accounting purposes if the ceiling is exceeded, even if prices were depressed for only a short period of time. We may be required to write down the carrying value of our gas and oil properties when natural gas and oil prices are depressed or unusually volatile, which would result in a charge against our earnings. Once incurred, a write-down of the carrying value of our natural gas and oil properties is not reversible at a later date.

Table of Contents

Competition in our industry is intense. We are small and have an extremely limited operating history as compared to the vast majority of our competitors, and we may not be able to compete effectively.

We intend to compete with major and independent natural gas and oil companies for property acquisitions. We will also compete for the equipment and labor required to operate and to develop natural gas and oil properties. The majority of our anticipated competitors have substantially greater financial and other resources than we do. In addition, larger competitors may be able to absorb the burden of any changes in federal, state and local laws and regulations more easily than we can, which would adversely affect our competitive position. These competitors may be able to pay more for natural gas and oil properties and may be able to define, evaluate, bid for and acquire a greater number of properties than we can. Our ability to acquire additional properties and develop new and existing properties in the future will depend on our ability to conduct operations, to evaluate and select suitable properties and to consummate transactions in this highly competitive environment. In addition, some of our competitors have been operating in our core areas for a much longer time than we have and have demonstrated the ability to operate through industry cycles.

The natural gas and oil business involves numerous uncertainties and operating risks that can prevent us from realizing profits and can cause substantial losses.

Our development, exploitation and exploration activities may be unsuccessful for many reasons, including weather, cost overruns, equipment shortages and mechanical difficulties. Moreover, the successful drilling of a natural gas and oil well does not ensure a profit on investment. A variety of factors, both geological and market-related, can cause a well to become uneconomical or only marginally economical. In addition to their cost, unsuccessful wells can hurt our efforts to replace reserves.

The natural gas and oil business involves a variety of operating risks, including:

- fires;
- explosions;
- blow-outs and surface cratering;
- uncontrollable flows of oil, natural gas, and formation water;
- natural disasters, such as hurricanes and other adverse weather conditions;
- pipe, cement, or pipeline failures;
- casing collapses;
- embedded oil field drilling and service tools;
- abnormally pressured formations; and
- environmental hazards, such as natural gas leaks, oil spills, pipeline ruptures and discharges of toxic gases.

If we experience any of these problems, it could affect well bores, gathering systems and processing facilities, which could adversely affect our ability to conduct operations. We could also incur substantial losses as a result of:

Table of Contents

- injury or loss of life;
- severe damage to and destruction of property, natural resources and equipment;
- pollution and other environmental damage;
- clean-up responsibilities;
- regulatory investigation and penalties;
- suspension of our operations; and
- repairs to resume operations.

Because we intend to use third-party drilling contractors to drill our wells, we may not realize the full benefit of worker compensation laws in dealing with their employees. Our insurance does not protect us against all operational risks. We do not carry business interruption insurance at levels that would provide enough funds for us to continue operating without access to other funds. For some risks, we may not obtain insurance if we believe the cost of available insurance is excessive relative to the risks presented. In addition, pollution and environmental risks generally are not fully insurable. If a significant accident or other event occurs and is not fully covered by insurance, it could impact our operations enough to force us to cease our operations.

The high cost of drilling rigs, equipment, supplies, personnel and other services could adversely affect our ability to execute on a timely basis our development, exploitation and exploration plans within our budget.

Shortages or an increase in cost of drilling rigs, equipment, supplies or personnel could delay or interrupt our operations, which could impact our financial condition and results of operations. Drilling activity in the geographic areas in which we conduct drilling activities may increase, which would lead to increases in associated costs, including those related to drilling rigs, equipment, supplies and personnel and the services and products of other vendors to the industry. Increased drilling activity in these areas may also decrease the availability of rigs. We do not have any contracts with providers of drilling rigs and we cannot assure you that drilling rigs will be readily available when we need them. Drilling and other costs may increase further and necessary equipment and services may not be available to us at economical prices.

Our lease ownership may be diluted due to financing strategies we may employ in the future due to our lack of capital or due to our focus on producing leases.

To accelerate our development efforts we plan to take on working interest partners that will contribute to the costs of drilling and completion and then share in revenues derived from production. In addition, we may in the future, due to a lack of capital or other strategic reasons, establish joint venture partnerships or farm out all or part of our development efforts. These economic strategies may have a dilutive effect on our lease ownership and will more than likely reduce our operating revenues.

Table of Contents

In addition, our lease ownership is subject to forfeiture in the event we are unwilling or unable to continue making lease payments. Our leases vary in price per acre and on the term period of the lease. Each lease requires payment to maintain an active lease, or have a producing well to hold the lease. In the event we are unable or unwilling to make our lease payments or renew expiring leases, then we will forfeit our rights to such leases. Such forfeiture would prevent us from pursuing development activity on the leased property and could have a substantial impact on our gross leased acreage.

We are subject to complex laws and regulations, including environmental regulations, which can adversely affect the cost, manner or feasibility of doing business.

Development, production and sale of natural gas and oil in the United States are subject to extensive laws and regulations, including environmental laws and regulations. We may be required to make large expenditures to comply with environmental and other governmental regulations. Matters subject to regulation include:

- location and density of wells;
- the handling of drilling fluids and obtaining discharge permits for drilling operations;
- accounting for and payment of royalties on production from state, federal and Indian lands;
- bonds for ownership, development and production of natural gas and oil properties;
- transportation of natural gas and oil by pipelines;
- operation of wells and reports concerning operations; and
- taxation.

Under these laws and regulations, we could be liable for personal injuries, property damage, oil spills, discharge of hazardous materials, remediation and clean-up costs and other environmental damages. Failure to comply with these laws and regulations also may result in the suspension or termination of our operations and subject us to administrative, civil and criminal penalties. Moreover, these laws and regulations could change in ways that substantially increase our costs. Accordingly, any of these liabilities, penalties, suspensions, terminations or regulatory changes could materially adversely affect our financial condition and results of operations enough to possibly force us to cease our business operations.

Our oil and gas operations may expose us to environmental liabilities.

Any leakage of crude oil and/or gas from the subsurface portions of our wells, our gathering system or our storage facilities could cause degradation of fresh groundwater resources, as well as surface damage, potentially resulting in suspension of operation of the wells, fines and penalties from governmental agencies, expenditures for remediation of the affected resource, and liabilities to third parties for property damages and personal injuries. In addition, any sale of residual crude oil collected as part of the drilling and recovery process could impose liability on us if the entity to which the oil was transferred fails to manage the material in accordance with applicable environmental health and safety laws.

Table of Contents

Estimates of proved reserves and related future net cash flows are not precise. The actual quantities of our proved reserves and future net cash flows may prove to be lower than estimated.

Many uncertainties exist in estimating quantities of proved reserves and related future net cash flows. Our estimates are based on various assumptions, which may ultimately prove to be inaccurate.

Tax law changes may adversely affect our operations.

In California, there have been proposals for tax increases for the past several years including a severance tax as high as 12.5% of the value of petroleum production in California. Although the proposals have not become law, campaigns by various interest groups could lead to future oil and gas severance taxes. The imposition of such a tax could severely reduce our profit margins and cash flow and could ultimately result in lower oil and natural gas production, which may reduce our capital investments and growth plans.

In addition, President Trump's budget proposal for fiscal year 2017 could recommend the elimination of certain federal income tax preferences currently available to oil and gas exploration and production companies as well as new taxes, all of which could harm us. The elimination of tax preferences includes (i) the repeal of the percentage depletion allowance for oil and gas properties, (ii) the elimination of expensing intangible drilling costs, (iii) an increase in the amortization period from two years to seven years for geological and geophysical costs paid or incurred by independent producers and (iv) repealing the domestic manufacturing deduction for income derived from the production of oil and gas in the United States.

Restrictions on our ability to obtain, use, manage or dispose of water may have an adverse effect on our operations.

Table of Contents

Water management is an essential component of our operations. We treat and re-use water for a substantial portion of our needs related to activities such as steamflooding, waterflooding, pressure management, well completion and stimulation, including limited hydraulic fracturing, and we provide reclaimed water for agricultural use in certain areas. We also use supplied water from various local and regional sources, particularly for power plants and to support operations like steam injection in certain fields. Due to severe drought in California, some local and regional water districts and the state government are implementing regulations and policies that restrict water usage and increase the cost of water. Existing laws and regulations restrict our ability and increase our cost to manage and dispose of water and other fluids. The federal Clean Water Act and Safe Drinking Water Act and analogous state laws impose restrictions and strict controls on the discharge of and injection of fluids, including produced water. We must obtain permits or waivers for certain surface discharges and subsurface injection, as well as for construction activities that may affect regulated water resources. Certain government agencies have investigated and continue to study whether the discharge or injection of produced water could affect water quality or induce ground movement or seismicity, which may result in additional regulations under federal and state laws. Our enhanced production operations or fluid disposal could give rise to litigation over claims related to alleged damage to the environment or private or public property. The laws, regulations, policies and attendant liabilities relating to the use, disposal and injection of water and other fluids could increase our costs and negatively affect our development and production activities.

Concerns about climate change and other air quality issues may affect our operations or results.

Concerns about climate change and regulation of greenhouse gases (GHGs) may affect our business in many ways, including increasing the costs to provide our products and services, and reducing demand for, and consumption of, our products and services. In addition, legislative and regulatory responses to climate change may increase our operating costs. California has led other states in adopting GHG emission reduction requirements as well as mandates for renewable fuel sources. In 2006, California adopted AB 32, which established a statewide cap on GHG emissions, including on the oil and natural gas production industry, and a “cap-and-trade” program. Since 2012, California Air Resources Board (CARB) regulations have required us to obtain GHG emissions allowances corresponding to reported GHG emissions from operations and, starting in 2015, from the sale of certain products to customers for use in California. The EPA has also adopted regulations requiring the reporting of GHG emissions from certain onshore oil and natural gas production facilities on an annual basis. In 2015, the EPA expanded the scope of the GHG monitoring and reporting rule to include gathering and compression facilities as well as completions and workovers from wells that have undergone hydraulic fracturing. The EPA also proposed regulations in 2015 that would require emission controls for methane from certain equipment and processes in the oil and natural gas source category, including production, processing, transmission and storage activities. These additional regulations could increase our costs.

Table of Contents

In addition, other current and proposed international agreements and federal and state laws, regulations and policies seek to restrict or reduce the use of petroleum products in transportation fuels and electricity generation, impose additional taxes and costs on producers and consumers of petroleum products and require or subsidize the use of renewable energy, which could increase our costs and reduce demand for our products and services. Federal and state regulatory agencies can impose administrative, civil and/or criminal penalties for non-compliance with air permits or other requirements of the federal Clean Air Act and associated state laws and regulations.

Risks Relating To Our Common Stock

Because our common stock is deemed a low-priced “Penny” stock, an investment in our common stock should be considered high risk and subject to marketability restrictions.

Since our common stock is currently under \$5 per share, it is considered a penny stock, as defined in Rule 3a51-1 under the Securities Exchange Act, it will be more difficult for investors to liquidate their investment even if and when a market develops for the common stock. Until the trading price of the common stock rises above \$5.00 per share, if ever, trading in the common stock is subject to the penny stock rules of the Securities Exchange Act specified in rules 15g-1 through 15g-10. Those rules require broker-dealers, before effecting transactions in any penny stock, to:

- Deliver to the customer, and obtain a written receipt for, a disclosure document;
- Disclose certain price information about the stock;
- Disclose the amount of compensation received by the broker-dealer or any associated person of the broker-dealer;
- Send monthly statements to customers with market and price information about the penny stock; and
- In some circumstances, approve the purchaser’s account under certain standards and deliver written statements to the customer with information specified in the rules.

Consequently, the penny stock rules may restrict the ability or willingness of broker-dealers to sell the common stock and may affect the ability of holders to sell their common stock in the secondary market and the price at which such holders can sell any such securities. These additional procedures could also limit our ability to raise additional capital in the future.

Table of Contents

FINRA sales practice requirements may also limit a stockholder's ability to buy and sell our stock.

In addition to the “penny stock” rules described above, the Financial Industry Regulatory Authority (FINRA) has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. The FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares.

If we fail to remain current on our reporting requirements, we could be removed from the OTC Markets QB (OTCQB), which would limit the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market.

Companies trading on the OTC Markets QB (OTCQB), such as us, generally must be reporting issuers under Section 12 of the Securities Exchange Act of 1934, as amended, and must be current in their reports under Section 13, in order to maintain price quotation privileges on the OTCQB. More specifically, FINRA has enacted Rule 6530, which determines eligibility of issuers quoted on the OTCQB by requiring an issuer to be current in its filings with the Commission. Pursuant to Rule 6530(e), if we file our reports late with the Commission three times in a two-year period or our securities are removed from the OTCQB for failure to timely file twice in a two-year period, then we will be ineligible for quotation on the OTCQB. As a result, the market liquidity for our securities could be severely adversely affected by limiting the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market. As of the date of this filing, we have one late filing reported by FINRA.

Table of Contents

Our internal controls may be inadequate, which could cause our financial reporting to be unreliable and lead to misinformation being disseminated to the public.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. As defined in Exchange Act Rule 13a-15(f), internal control over financial reporting is a process designed by, or under the supervision of, the principal executive and principal financial officer and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of Citadel; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of Citadel are being made only in accordance with authorizations of management and directors of Citadel, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Citadel's assets that could have a material effect on the consolidated financial statements.

We have two individuals performing the functions of all officers and directors. These individuals developed our internal control procedures and are responsible for monitoring and ensuring compliance with those procedures. As a result, our internal controls may be inadequate or ineffective, which could cause our financial reporting to be unreliable and lead to misinformation being disseminated to the public. Investors relying upon this misinformation may make an uninformed investment decision.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We received notice on or about July 10, 2013 that the Center for Biological Diversity ("CBD") had filed a law suit against the County of San Benito regarding the approval of Project Indian which is described more fully, above, as the "Case". The Board of Supervisors voted 5-0 in favor of our application to drill 15 exploration wells on our Project Indian lease. The Court approved the petition in a judgment entered on September 4, 2014, and ruled that Citadel was required to obtain an environmental impact report before commencing Project Indian. Thereafter, the Court awarded the petitioner \$347,969 as attorney's fees and costs against the County of San Benito and Citadel, jointly and severally. The Company has requested a dismissal of its appeal of this decision which was granted as the Court required the Company to post a bond in which it was unable to qualify for. In October of 2015, the company paid \$92,693 to the Center for Biological Diversity for a share of the attorney's fees and costs outstanding which satisfied the judgment for attorney's fees and costs in full. In October of 2015, the company entered into a summary judgement with the County of San Benito to pay \$262,500 in related costs of the CBD litigation. The company is required to pay \$25,000 per quarter for the next six quarters and a lump sum payment of the remaining balance in the first quarter of 2018. This puts to an end any future costs associated with litigation regarding Project Indian in San Benito County.

Table of Contents

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

ITEM 4. MINE SAFETY DISCLOSURES

None

Table of Contents

PART II

ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASE OF EQUITY SECURITIES

Market Information

Our common stock is quoted on the OTC Markets QB (OTCQB), under the symbol “COIL.” Historically, there has not been an active trading market for our common stock. We have been eligible to participate on the OTCQB since November 2010.

The following table sets forth the quarterly high and low bid prices for our common stock during our last two fiscal years, as reported by a Quarterly Trade and Quote Summary Report of the OTC Bulletin Board. The quotations reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not necessarily represent actual transactions.

	2016				2015			
	BID PRICES		BID PRICES		BID PRICES		BID PRICES	
	High	Low	High	Low	High	Low	High	Low
1 st Quarter	\$ 0.23	\$ 0.20	\$ 0.15	\$ 0.03	\$ 0.15	\$ 0.03	\$ 0.15	\$ 0.03
2 nd Quarter	\$ 0.29	\$ 0.23	\$ 0.10	\$ 0.03	\$ 0.10	\$ 0.03	\$ 0.10	\$ 0.03
3 rd Quarter	\$ 0.30	\$ 0.15	\$ 0.34	\$ 0.07	\$ 0.34	\$ 0.07	\$ 0.34	\$ 0.07
4 th Quarter	\$ 0.23	\$ 0.12	\$ 0.32	\$ 0.07	\$ 0.32	\$ 0.07	\$ 0.32	\$ 0.07

Holders of Common Stock

As of March 31, 2017, we had approximately 121 stockholders of record of the 41,348,002 shares outstanding.

Dividends

The payment of dividends is subject to the discretion of our Board of Directors and will depend, among other things, upon our earnings, our capital requirements, our financial condition, and other relevant factors. We have not paid or declared any dividends upon our common stock since our inception and, by reason of our present financial status and our contemplated financial requirements, do not anticipate paying any dividends upon our common stock in the foreseeable future.

We intend to reinvest any earnings in the development and expansion of our business. Any cash dividends in the future to common stockholders will be payable when, as and if declared by our Board of Directors, based upon the Board’s assessment of:

- our financial condition;
- earnings;
- need for funds;
- capital requirements;
- prior claims of preferred stock to the extent issued and outstanding; and
- other factors, including any applicable laws.

Therefore, there can be no assurance that any dividends on the common stock will ever be paid.

[Table of Contents](#)

Securities Authorized for Issuance under Equity Compensation Plans

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, 9,500,000 options and no shares of common stock have been granted under this plan.

Recent Sales of Unregistered Securities

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

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

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

In July of 2015, the Company approved the issuance of 6,000,000 common stock shares as partial consideration for the purchase of the Kern Bluff Oil Field.

In March of 2016, the Company approved the sale of up to 250,000 shares of Series A Convertible Participating Preferred Stock. The Company sold 175,000 shares of Series A Convertible Participating Preferred Stock to convert its \$3,500,000 related party note payable to preferred stock payable. In addition, the Company has sold 21,250 shares of Series A Convertible Participating Preferred Stock payable for cash in the amount of \$425,000 through March 31, 2016.

In June of 2016, the Company sold 50,000 shares of Series A Convertible Participating Preferred Stock payable for cash in the amount of \$1,000,000.

In September of 2016, the Company sold 26,500 shares of Series A Convertible Participating Preferred Stock payable for cash in the amount of \$530,000. The Company issued 500,000 shares of common stock for cash in the amount of \$100,000.

In October of 2016, the Company sold 10,350 shares of Series A Convertible Participating Preferred Stock payable for cash in the amount of \$207,000.

In November of 2016, the Company sold 29,330 shares of Series A Convertible Participating Preferred Stock payable for cash in the amount of \$586,600.

In December of 2016, the Company sold 13,300 shares of Series A Convertible Participating Preferred Stock payable for cash in the amount of \$266,000.

Issuer Purchases of Equity Securities

The Company did not repurchase any of its equity securities during the year ended December 31, 2016.

[Table of Contents](#)

ITEM 6. SELECTED FINANCIAL DATA

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

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW AND OUTLOOK

Background

Citadel Exploration, Inc. was incorporated in the State of Nevada in December of 2009. On February 28, 2011, we entered into an agreement for the acquisition of 100% of the membership interest of Citadel Exploration, LLC ("CEL"), a California limited liability company.

On March 2, 2011, we changed our name from Subprime Advantage, Inc. to Citadel Exploration, Inc. in anticipation of the completion of the acquisition of 100% of all of the outstanding membership interest of CEL. The acquisition of 100% of the outstanding membership interest of CEL was completed on May 3, 2011. As a result of the completion of the acquisition, we became an oil and gas exploration company with operations in the Salinas and San Joaquin Basins of California. We have since expanded our focus to be an oil and gas exploration, development and production company.

Our Operations

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

Table of Contents

In December of 2014, Citadel began a work-over on the Yowlumne #2-26 well including installation of a new pump in February of 2015. The well has been producing approximately 20- 25 barrels per day (32 degree API quality) since the beginning of March. In June the well's pump had a mechanical issue, the company performed well maintenance in August returning the well to its previous production level. During December of 2015, extremely cold weather forced the shut-down of the #2-26 well. Citadel plans to return the well to production in the second or third quarter of 2017. Citadel is in the final stages of the CEQA process to permit two additional exploration wells on the Yowlumne acreage. Recent regulatory changes, including SB4 the State of California's bill on fracking have delayed the final approval of our CEQA application. As such we do not expect to have these prospects permitted until the end of 2017, at which time we will determine when to drill. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 15,000 feet. Citadel currently has a 75% working interest in these exploration prospects and is the operator.

On July 31, 2015 Citadel acquired approximately 1,100 acres of leases, production facilities and equipment that encompassed the Kern Bluff Oil Field. As consideration for this acquisition Citadel issued 6,000,000 shares of common stock and paid \$2,000,000 in cash. The transaction was financed via a \$3,500,000 one year term loan from Cibolo Creek Partners, of Midland Texas. In March of 2016, Cibolo Creek Partners converted the \$3,500,000 term loan into Series A Convertible Participating Preferred Stock.

In December of 2015, Citadel shifted its CAPEX focus to remediation of the existing acquired facilities. At the time of purchase, the oil at Kern Bluff was being processed by temporary facilities installed by the previous owner. As production increased in September, it quickly became apparent that these facilities were not capable of processing the additional volumes of oil and water being produced. The existing permanent facilities were built in the 1970's by Gulf Oil and require extensive remediation including new pipe, valves, flanges and tank repair. In order to facilitate the remediation, Citadel elected to shut down the eight producing wells in early January.

In July of 2016, Citadel completed its facility upgrades; the new facilities have production capacity of 500-700 BOPD. Citadel drilled three wells in June and returned to production 9 idle wells. Production from the new wells continues to increase as the wells clean up. As of December 31, 2016 the Company was producing approximately 30 barrels of oil per day. The Company is currently working on purchasing and or renting a steam generator, to begin cyclic steaming operations in the 2nd quarter of 2017. The Company believes that cyclic steaming of the existing wells, should double its current production.

Table of Contents

Going Concern

The consolidated 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 any significant revenues from operations. As shown on the accompanying consolidated financial statements, the Company has incurred a net loss of \$2,150,059 for the year ending December 31, 2016. 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

For accounting purposes, the acquisition of Citadel Exploration, LLC by the Company has been recorded as a reverse acquisition of a public company and recapitalization of Citadel Exploration, LLC based on the factors demonstrating that Citadel Exploration, LLC represents the accounting acquirer. The historic financial statements of Citadel Exploration, LLC and related entities, while historically presented as an LLC equity structure, have been retroactively presented as a corporation for comparability purposes.

During the year ended December 31, 2016 we generated \$107,071 in revenue from oil sales. During the year ended December 31 2015, we generated \$118,327 in revenue.

Operating expenses totaled \$1,676,826 during the year ended December 31, 2016 as compared to \$1,413,323 in the prior year ended December 31, 2015. Operating expenses primarily consisted of lease operating expenses, executive compensation, and general and administrative expenses in the year ended December 31, 2016.

General and administrative fees increased \$224,515 from the year ended December 31, 2015 to the year ended December 31, 2016. This increase was primarily due to insurance, marketing and meals and entertainment expenses.

Professional fees increased \$142,500 from the year ended December 31, 2015 to the year ended December 31, 2016. The increase was primarily due to an increase in services provided to the Company for accounting, consulting and legal.

Executive compensation decreased \$258,444 from the year ended December 31, 2015 to the year ended December 31, 2016. The decrease was due to ending of the stock option expense amortization.

Table of Contents

Liquidity and Capital Resources

The Company has established a capital budget for 2017 of \$6,000,000 to purchase or rent a 20MM BTU steam generator, return to production up to 10 wells and drill up to 20 vertical wells and 1 horizontal well. The Company's ability to complete this capital budget will be highly dependent on higher oil prices and access to capital.

As of December 31, 2016, we had \$234,252 of current assets; of this amount \$188,793 was cash. The following table provides detailed information about our net cash flow for all consolidated financial statement periods presented in this Annual Report. To date, we have financed our operations through the issuance of stock and borrowings.

The following table sets forth a summary of our cash flows for the years ended December 31, 2016 and 2015:

	Years Ended December 31,	
	2016	2015
Net cash used in operating activities	\$ (1,028,947)	\$ (819,253)
Net cash used in investing activities	(2,045,260)	(2,930,426)
Net cash provided by financing activities	3,116,445	3,625,936
Net increase (decrease) in cash	42,238	(123,743)
Cash, beginning of year	146,555	270,298
Cash, end of year	\$ 188,793	\$ 146,555

Investing activities

Net cash used in investing activities was \$2,045,260 for the year ended December 31, 2016. The net cash used in investing activities consisted primarily of payments for the development of Kern Bluff Oil Field.

Financing activities

Net cash provided by financing activities for the year ended December 31, 2016 was \$3,116,445. The net cash provided by financing activities substantially consisted of proceeds from a \$3,014,600 preferred stock sale, note repayments totaling \$66,891, and common stock proceeds, net of offering costs, of \$100,000.

As of December 31, 2016, 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.

Table of Contents

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 projects, 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.

Contractual Obligations

An operating lease for rental office space was entered into beginning March 1, 2013 for two years at \$2,150 per month. The original lease was amended to include additional space at a price of \$1,100 per month for the same term. The original term of the lease expired on March 1, 2015. As such our office lease is now on a month to month basis at a rate of \$3,000 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.

Table of Contents

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 only generated minimal revenue from the sale of oil or natural gas. Our activities have been limited to raising capital, negotiating WI agreements, becoming a publicly traded company and preliminary analysis of reserves and production capabilities from our exploratory test wells.

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

[Table of Contents](#)

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

	PAGES
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	F-1
CONSOLIDATED BALANCE SHEETS	F-2
CONSOLIDATED STATEMENTS OF OPERATIONS	F-3
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)	F-4
CONSOLIDATED STATEMENTS OF CASH FLOWS	F-5
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS	F-6 – F-19

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

We have had no disagreements with our independent auditors on accounting or financial disclosures.

[Table of Contents](#)

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our Principal Executive Officer, Armen Nahabedian and Principal Financial Officer, Philip McPherson, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Report. Based on their evaluation, they 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 officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control, as is defined in the Securities Exchange Act of 1934. These internal controls are designed to provide reasonable assurance that the reported financial information is presented fairly, that disclosures are adequate and that the judgments inherent in the preparation of consolidated financial statements are reasonable. There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and overriding of controls. Consequently, an effective internal control system can only provide reasonable, not absolute, assurance with respect to reporting financial information.

Our internal control over financial reporting includes policies and procedures that: (i) pertain to maintaining records that in reasonable detail accurately and fairly reflect our transactions; (ii) provide reasonable assurance that transactions are recorded as necessary for preparation of our consolidated financial statements in accordance with generally accepted accounting principles and the receipts and expenditures of company assets are made and in accordance with our management and directors authorization; and (iii) provide reasonable assurance regarding the prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on our consolidated financial statements.

Management has undertaken an assessment of the effectiveness of our internal control over financial reporting based on the framework and criteria established in the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based upon this evaluation, management concluded that our internal control over financial reporting was not effective as of December 31, 2016.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to the temporary rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

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 reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

Table of Contents

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Directors and Executive Officers

The names of our directors and executive officers and their ages, positions, and biographies are set forth below. Our executive officers are appointed by, and serve at the discretion of, our board of directors. There are no family relationships among any of our directors or executive officers.

Name	Age	Title	Director Since
Armen Nahabedian	38	Chief Executive Officer, President & Director	8/9/2011
Daniel Szymanski	55	Director	5/3/2011
Philip J. McPherson	42	Chief Financial Officer, Secretary, Treasurer & Director	9/1/2012
Jim Walesa	56	Chairman of the Board	9/1/2014
James Borgna	39	Director	5/3/2011

Armen Nahabedian, 38, President, Chief Executive Officer, and Director: Mr. Nahabedian is a fourth generation oil and gas explorer in the state of California. In 1999, Mr. Nahabedian joined the United States Marine Corp as an infantryman and reached the rank of Corporal (E-4) before serving in operation Iraqi Freedom and receiving an honorable discharge in 2003. Mr. Nahabedian immediately thereafter went to work in the oil fields of the South San Joaquin Valley for his family's oil company, The Nahabedian Exploration Group. After early success in his exploration efforts Mr. Nahabedian became a regional supervisor and managed the drilling operations for some of the deepest exploratory wells drilled in the state of California from 2004 through 2007. In 2007, Mr. Nahabedian then joined The Nahabedian Exploration Group as a partner and supervised land acquisition efforts (over 750,000 acres leased or optioned) and prospect generation. Mr. Nahabedian continued to act as an operational supervisor and in 2009; he became involved in business development and finance. Acting as the company's primary fund raiser Mr. Nahabedian educated himself in public financing and securities and with the assistance of an experienced legal team formed Citadel Exploration, Inc. in 2011.

Daniel L. Szymanski, 55, Director: Dan Szymanski comes to the board of Citadel Exploration, Inc. with over 20 years of industry experience, including exploration and production assignments with Tenneco and Chevron, and worldwide exploration with Occidental. Dan served as Manager of Business Development, then Manager-Financial Planning and Analysis at Oxy's Headquarters in LA. His final role at Oxy was Asset Manager for 42 oil and gas fields producing in California's San Joaquin and Sacramento Valleys. Since 2008, Dan has been a consultant to the oil and gas industry and partner in a seismic data firm. Mr. Szymanski has a Bachelors degree in Geology from the University of Wisconsin and a Masters in Geophysics from Purdue.

Table of Contents

Philip J. McPherson, 42, Chief Financial Officer and Director: Mr. McPherson joined Citadel Exploration in September of 2012 with nearly two decades of experience in the capital markets and financial services sectors. He started his career as a retail stock broker with Mission Capital in 1997 and became partner before it was acquired by oil and gas boutique C. K. Cooper & Company. At C.K. Cooper, Mr. McPherson was a research analyst specializing in small cap exploration & production companies. In 2007, he joined Global Hunter Securities as a partner and managing director of the energy research group. During his Wall Street career, Mr. McPherson was presented the Wall Street Journal “Best on the Street” Award was named a Zack’s 5-Start Analyst for three consecutive years. He is a recognized expert on California E&P firms. Mr. McPherson received his Bachelors in Economics from East Carolina University.

James Walesa, 56, Chairman of the Board: Mr. Walesa has more than three decades of experience in financial services with an emphasis on the energy industry. He started in 1982 with First Investors (FIC) as a registered representative in Chicago and became the youngest vice president in firm history at age 26. He left FIC to form Asset Management & Protection Corporation (AMPC) in May 1988. AMPC started from scratch and today manages over \$500 million. Mr. Walesa entered the energy industry in 1992 in the Permian Basin. He and some of his clients were original investors in Basic Energy Services (BAS: NYSE) and Southwest Royalties, now part of Clayton Williams Energy (CWE: NYSE). He is also a founding member of the Offshore Energy Center in Galveston, Texas. Mr. Walesa and AMPC clients continue to provide startup capital for energy related companies and was an original investor in Citadel’s first offering. Mr. Walesa previously served on the board of NASDAQ-traded Financial Assurance and several private companies. He was the Chicago Chairman for the National Multiple Sclerosis Society and is a member of the Alzheimer’s Alois Society in recognition of his leadership and support of the Alzheimer’s Association to prevent and cure dementia related disease.

James Borgna, 38, Director: Mr. Borgna is a third generation oil and gas industry supplier and producer. Mr. Borgna currently owns and operates Grey Energy LLC which supplies production facilities and process equipment in California. Mr. Borgna specializes in scalable facilities that are fabricated work in-house. Mr. Borgna has supervised the fabrication of oil and gas facilities for many of the major operators in the San Joaquin Basin. Mr. Borgna gained valuable experience with project management, facilities design, and gained familiarity with permitting guidelines and restrictions. Prior to joining his family in the oil and gas industry Mr. Borgna served six years in the United States Navy and achieved the rank of E-5.

Indemnification of Directors and Officers

Our Articles of Incorporation and Bylaws both provide for the indemnification of our officers and directors to the fullest extent permitted by Nevada law.

Limitation of Liability of Directors

Pursuant to the Nevada General Corporation Law, our Articles of Incorporation exclude personal liability for our Directors for monetary damages based upon any violation of their fiduciary duties as Directors, except as to liability for any breach of the duty of loyalty, acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, or any transaction from which a Director receives an improper personal benefit. This exclusion of liability does not limit any right which a Director may have to be indemnified and does not affect any Director’s liability under federal or applicable state securities laws. We have agreed to indemnify our directors against expenses, judgments, and amounts paid in settlement in connection with any claim against a Director if he acted in good faith and in a manner he believed to be in our best interests.

Table of Contents

Election of Directors and Officers

Directors are elected to serve until the next annual meeting of stockholders and until their successors have been elected and qualified. Officers are appointed to serve until the meeting of the Board of Directors following the next annual meeting of stockholders and until their successors have been elected and qualified.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), requires our executive officers and directors, and persons who beneficially own more than ten percent of our common stock, to file initial reports of ownership and reports of changes in ownership with the SEC. Executive officers, directors and greater-than-ten-percent beneficial owners are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file. Based upon a review of the copies of such forms furnished to us and written representations from our executive officers and directors, we believe that as of the date of this filing they were current in their filings.

Code of Ethics

A code of ethics relates to written standards that are reasonably designed to deter wrongdoing and to promote:

- (1) Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- (2) Full, fair, accurate, timely and understandable disclosure in reports and documents that are filed with, or submitted to, the Commission and in other public communications made by an issuer;
- (3) Compliance with applicable governmental laws, rules and regulations;
- (4) The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and
- (5) Accountability for adherence to the code.

We have not adopted a corporate code of ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions.

Our decision to not adopt such a code of ethics results from our having a small management for the Company. We believe that the limited interaction which occurs having such a small management structure for the Company eliminates the current need for such a code, in that violations of such a code would be reported to the party generating the violation.

Corporate Governance

We currently do not have standing audit, nominating and compensation committees of the board of directors, or committees performing similar functions. Until formal committees are established, our entire board of directors, perform the same functions as an audit, nominating and compensation committee.

Table of Contents

Involvement in Certain Legal Proceedings

To the best of our knowledge, none of our directors or executive officers has, during the past five years:

- been convicted in a criminal proceeding or been subject to a pending criminal proceeding (excluding traffic violations and other minor offences);
- had any bankruptcy petition filed by or against the business or property of the person, or of any partnership, corporation or business association of which he was a general partner or executive officer, either at the time of the bankruptcy filing or within two years prior to that time;
- been subject to any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction or federal or state authority, permanently or temporarily enjoining, barring, suspending or otherwise limiting, his involvement in any type of business, securities, futures, commodities, investment, banking, savings and loan, or insurance activities, or to be associated with persons engaged in any such activity;
- been found by a court of competent jurisdiction in a civil action or by the SEC or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated;
- been the subject of, or a party to, any federal or state judicial or administrative order, judgment, decree, or finding, not subsequently reversed, suspended or vacated (not including any settlement of a civil proceeding among private litigants), relating to an alleged violation of any federal or state securities or commodities law or regulation, any law or regulation respecting financial institutions or insurance companies including, but not limited to, a temporary or permanent injunction, order of disgorgement or restitution, civil money penalty or temporary or permanent cease-and-desist order, or removal or prohibition order, or any law or regulation prohibiting mail or wire fraud or fraud in connection with any business entity; or
- been the subject of, or a party to, any sanction or order, not subsequently reversed, suspended or vacated, of any self-regulatory organization (as defined in Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26))), any registered entity (as defined in Section 1(a)(29) of the Commodity Exchange Act (7 U.S.C. 1(a)(29))), or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

[Table of Contents](#)

ITEM 11. EXECUTIVE COMPENSATION

Overview of Compensation Program

We currently have not appointed members to serve on the Compensation Committee of the Board of Directors. Until a formal committee is established, our entire Board of Directors has responsibility for establishing, implementing and continually monitoring adherence with the Company's compensation philosophy. The Board of Directors ensures that the total compensation paid to the executives is fair, reasonable and competitive.

Compensation Philosophy and Objectives

The Board of Directors believes that the most effective executive compensation program is one that is designed to reward the achievement of specific annual, long-term and strategic goals by the Company and that aligns executives' interests with those of the stockholders by rewarding performance above established goals, with the ultimate objective of improving stockholder value. As a result of the size of the Company, the Board evaluates both performance and compensation on an informal basis. Upon hiring additional executives, the Board intends to establish a Compensation Committee to evaluate both performance and compensation to ensure that the Company maintains its ability to attract and retain superior employees in key positions and that compensation provided to key employees remains competitive relative to the compensation paid to similarly-situated executives of peer companies. To that end, the Board believes executive compensation packages provided by the Company to its executives, including the named executive officers, should include both cash and stock-based compensation that reward performance as measured against established goals.

Role of Executive Officers in Compensation Decisions

The Board of Directors makes all compensation decisions for, and approves recommendations regarding equity awards to, the executive officers and Directors of the Company. Decisions regarding the non-equity compensation of other employees of the Company are made by management.

Summary Compensation

During the year ended December 31, 2015, we entered into new employment contracts with both our CEO and CFO on September 1, 2015. The contract calls for each to receive a base salary of \$20,000 per month for the first 12 months. The base salary shall increase to \$25,000 per month for the next 12 month period and then increase to \$30,000 per month for the final 12 months of the three year contract. As of the date of the salary increase, the CEO and CFO have deferred payment of approximately \$10,000 per month of salary during the first year of the contract and \$15,000 per month during the second year of the contract. The CEO and CFO are also entitled to quarterly and annual bonuses upon reaching mutually agreeable objectives set by Employer and Employee. The CEO and CFO shall be entitled to receive and or participate in all benefit plans and programs of Employer currently existing or hereafter made available to executives and or senior management of the Employer.

[Table of Contents](#)

Summary Compensation Table

The table below summarizes the total compensation earned by our Executive Officers but does not account for deferred compensation as discussed above, for the last two fiscal years ended December 31, 2016 and 2015.

SUMMARY COMPENSATION TABLE

Name and Principal Positions	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
Armen Nahabedian,	2016	\$260,000	-0-	-0-	-0-	-0-	-0-	-0-	\$260,000
Chief Executive Officer, President, and Director									
(1)	2015	240,000	-0-	-0-	123,700	-0-	-0-	-0-	363,700
Philip McPherson	2016	\$260,000	-0-	-0-	-0-	-0-	-0-	-0-	\$260,000
Chief Financial Officer, Secretary, Treasurer, and Director									
(2)	2015	240,000	-0-	-0-	123,700	-0-	-0-	-0-	363,700

(1) Mr. Nahabedian was appointed Chief Executive Officer, President, and a Director of the Company on August 9, 2011.

(2) Mr. McPherson was appointed Chief Financial Officer, Secretary, Treasurer, and a Director of the Company on September 1, 2012.

Table of Contents

Termination of Employment

Pursuant to the terms of the employment contracts for the company's CEO and CFO, in the event of a change of control the CEO and CFO are entitled to five years of current monthly salary and five years of medical insurance. Additionally all unvested stock options immediately vest.

Option Grants in Last Fiscal Year

On July 29, 2015 the Board of Directors approved the granting of 4,700,000 stock options at \$0.15 per share for a term of seven years to three of the five board members and to the newly appointed General Counsel. These stock options were granted under the current 2012 Stock Incentive Plan for up to 10,000,000 shares. Currently the Company has granted 9,500,000 shares under this plan.

Director Compensation

As a result of having limited capital resources we do not currently have an established compensation package for our board members. Therefore the Board of Directors approved issuing 200,000 stock options at \$0.55 per share in 2014 as compensation.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information, to the best of our knowledge, about the beneficial ownership of our common stock on March 31, 2017 relating to the beneficial ownership of our common stock by those persons known to beneficially own more than 5% of our capital stock and by our directors and executive officers. The percentage of beneficial ownership for the following table is based on 41,348,002 shares of common stock outstanding.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and does not necessarily indicate beneficial ownership for any other purpose. Under these rules, beneficial ownership includes those shares of common stock over which the stockholder has sole or shared voting or investment power. The percentage ownership of the outstanding common stock, however, is based on the assumption, expressly required by the rules of the Securities and Exchange Commission, that only the person or entity whose ownership is being reported has converted options or warrants into shares of our common stock.

Table of Contents

Security Ownership of Certain Beneficial Owners and Management

<u>Title of Class</u>	<u>Name and address of Beneficial Owner⁽¹⁾</u>	<u>Number Of Shares</u>	<u>Percent Beneficially Owned</u>
Common	Armen Nahabedian, Chief Executive Officer, President & Director	4,421,500	11.0%
Common	Daniel L. Szymanski, Chairman of the Board	250,000	1.0%
Common	Philip J. McPherson, CFO & Director	2,030,000	5.0%
Common	James Walesa, Director ⁽²⁾	2,059,364	5.0%
Common	James Borgna, Director	200,000	0.9%
Common	Kern Bluff Resources, LLC	6,000,000	16.0%
Common	Vahagn Nahabedian	4,000,000	11.0%
All Beneficial Owners as a Group		18,960,864	48.0%

- (1) As used in this table, “beneficial ownership” means the sole or shared power to vote, or to direct the voting of, a security, or the sole or shared investment power with respect to a security (i.e., the power to dispose of, or to direct the disposition of, a security).

Each Parties’ address is care of the Company at 417 31st St. Unit A, Newport Beach, CA 92663

- (2) Includes 1,425,000 shares owned by Cibolo Creek Partners of which Mr. Walesa is a member.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Transactions with Related Persons

During the year ended December 31, 2016, the Company made the following purchases from entities considered related parties; \$364,253 for oil field equipment and services from Grey Energy. Grey Energy is owned by James Borgna, who is a member of our Board of Directors.

In December 2014, we entered an agreement with Jim Walesa and Cibolo Creek Partners to fund \$300,000 towards the Yowlumne #2-26 recompletion. In this agreement Mr. Walesa and Cibolo Creek will receive 75% of the net revenue after expenses, until they have received \$300,000 in payment. Upon full repayment, Mr. Walesa and Cibolo Creek will receive a 3% royalty on the well. Mr. Walesa is currently on the Board of Directors of Citadel and a member of Cibolo Creek Partners.

Promoters and Certain Control Persons

We did not have any promoters at any time since our inception in December 2009.

Director Independence

We currently have three independent directors, as the term “independent” is defined in Section 803A of the NYSE Amex LLC Company Guide. Since the OTCQB does not have rules regarding director independence, the Board makes its determination as to director independence based on the definition of “independence” as defined under the rules of the New York Stock Exchange (“NYSE”) and American Stock Exchange (“Amex”).

Table of Contents

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

(1) AUDIT FEES

Audit and Non-Audit Fees

The following table sets forth the fees paid or accrued by us for the audit and other services provided by Anton and Chia, LLP for the audit of our annual consolidated financial statements for the year ended December 31, 2016 and for year ended December 31, 2015:

	Fiscal Year Ended December 31, 2016	Fiscal Year Ended December 31, 2015
Audit Fees ⁽¹⁾	\$ 23,550	\$ 22,235
2014 Re-Audit Fees	\$ —	\$ 14,175
Tax Fees	\$ —	\$ —
All Other Fees	\$ —	\$ —
Total	\$ 23,550	\$ 36,410

(1) Audit Fees: This category represents fees for professional services provided in connection with the audit of our consolidated financial statements and review of our quarterly consolidated financial statements.

(2) AUDIT-RELATED FEES

None.

(3) TAX FEES

None.

(4) ALL OTHER FEES

None.

(5) AUDIT COMMITTEE POLICIES AND PROCEDURES

We do not have an audit committee.

(6) If greater than 50 percent, disclose the percentage of hours expended on the principal accountant's engagement to audit the registrant's consolidated financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees.

Not applicable.

Table of Contents

PART IV

ITEM 15. EXHIBITS, CONSOLIDATED FINANCIAL STATEMENT SCHEDULES

(a) We have filed the following documents as part of this Annual Report on Form 10-K:

1. The consolidated financial statements listed in the "Index to Consolidated Financial Statements" at page are filed as part of this report.
2. Consolidated financial statement schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.
3. Exhibits included or incorporated herein: See index to Exhibits.

Exhibit Index

Exhibit Number	Exhibit Description	Filed herewith	Incorporated by reference		
			Form	Period ending	Filing date
3(i)(a)	Articles of Incorporation of Citadel Exploration, Inc.		S-1	3(i)(a)	2/11/10
3(i)(b)	Certificate of Amendment – Name Change – Dated March 3, 2011		8-K	3(i)(b)	3/10/11
3(i)(c)	Certificate of Change – Dated March 3, 2011		8-K	3(i)(c)	3/10/11
3(ii)(a)	Bylaws of Citadel Exploration, Inc.		S-1	3(ii)(a)	2/11/10
10.1	Membership Purchase Agreement and Plan of Reorganization– Dated February 28, 2011		8-K	2.1	3/31/11
10.2	Addendum No. 1 to Membership Purchase Agreement and Plan of Reorganization – Dated April 27, 2011		8-K	2.2	5/3/11
10.3	Letter Agreement – Dated February 22, 2012		8-K	10.1	3/22/12
10.4	Bridge Loan Agreement		8-K	10.4	4/4/14
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	X			
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	X			
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	X			
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	X			
99.2	Presentation – Dated November 10, 2011		8-K	EX. 99.2	11/15/12
99.3	MHA Reserve Report – Dated March 22, 2017		10-K	EX. 99.3	04/01/17
101.INS**	XBRL Instance Document	X			
101.SCG**	XBRL Taxonomy Extension Schema	X			
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase	X			
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X			
101.LAB**	XBRL Taxonomy Extension Label Linkbase	X			
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase	X			

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

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused the report to be signed on its behalf by the undersigned, thereunto duly authorized.

CITADEL EXPLORATION, INC.

By: /s/Armen Nahabedian
Armen Nahabedian, President

Date: March 31, 2017

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/Armen Nahabedian</u> Armen Nahabedian	Chief Executive Officer (Principal Executive Officer), President, and Director	March 31, 2017
<u>/s/Philip J. McPherson</u> Philip J. McPherson	Chief Financial Officer (Principal Financial Officer) Secretary, Treasurer, and Director	March 31, 2017
<u>/s/Daniel L. Szymanski</u> Daniel L. Szymanski	Director	March 31, 2017
<u>/s/James Walesa</u> James Walesa	Chairman of the Board	March 31, 2017
<u>/s/James Borgna</u> James Borgna	Director	March 31, 2017

Table of Contents

**CITADEL EXPLORATION, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2016 AND 2015**

	PAGES
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	F-1
CONSOLIDATED BALANCE SHEETS	F-2
CONSOLIDATED STATEMENTS OF OPERATIONS	F-3
CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT	F-4
CONSOLIDATED STATEMENTS OF CASH FLOWS	F-5
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS	F-6 – F-19



CERTIFIED PUBLIC ACCOUNTANTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Citadel Exploration, Inc.

We have audited the accompanying consolidated balance sheets of Citadel Exploration, Inc. and subsidiary (“the Company”) as of December 31, 2016 and 2015, and the related consolidated statements of operations, stockholders' deficit, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citadel Exploration, Inc. and subsidiary of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has incurred losses from operations, which raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Anton & Chia, LLP
Newport Beach, CA
March 31, 2017

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Consolidated Balance Sheets

	December 31, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash	\$ 188,793	\$ 146,555
Other receivable	7,142	19,342
Prepaid expenses	33,436	29,870
Product inventory	4,881	4,881
Total current assets	<u>234,252</u>	<u>200,648</u>
Deposits	9,900	9,900
Restricted cash	245,000	245,000
Oil and gas properties (successful efforts basis), buildings and equipment, net	6,209,546	4,173,307
Equipment, net	18,530	13,860
Total assets	<u>\$ 6,717,228</u>	<u>\$ 4,642,715</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,584,258	\$ 1,047,169
Accrued interest payable	780,049	227,945
Notes payable, net	526,880	525,034
Notes payable, net (related party)	—	3,500,000
Preferred stock payable	6,514,600	—
Total current liabilities	<u>9,405,787</u>	<u>5,300,148</u>
Asset retirement obligation	217,212	198,279
Production payment liability	300,000	300,000
Total liabilities	<u>\$ 9,922,999</u>	<u>\$ 5,798,427</u>
Stockholders' deficit:		
Common stock, \$0.001 par value, 100,000,000 shares authorized, 39,314,000 and 38,814,000 shares issued and outstanding as of December 31, 2016 and December 31, 2015, respectively	39,314	38,814
Additional paid-in capital	5,790,060	5,690,560
Accumulated deficit	(9,035,145)	(6,885,086)
Total stockholders' deficit	<u>(3,205,771)</u>	<u>(1,155,712)</u>
Total liabilities and stockholders' deficit	<u>\$ 6,717,228</u>	<u>\$ 4,642,715</u>

See accompanying notes to consolidated financial statements.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Consolidated Statements of Operations

	For the years ended December 31,	
	<u>2016</u>	<u>2015</u>
Revenue	\$ 107,071	\$ 118,327
Operating expenses:		
Lease operating expense	221,160	199,908
Geological and geophysical expense	—	9,985
General and administrative	530,986	306,471
Depreciation, depletion and amortization	23,285	20,226
Professional fees	209,910	67,410
Executive compensation	550,879	809,323
Dry hole, abandonment, impairment, and exploration	140,606	—
Total operating expenses	<u>1,676,826</u>	<u>1,413,323</u>
Other expenses:		
Loss – contingency	—	(87,000)
Loss – notes payable settlement	—	(26,080)
Interest expense	(572,025)	(220,413)
Total other expenses	<u>(572,025)</u>	<u>(333,413)</u>
Loss before provision for income taxes	(2,141,780)	(1,628,409)
Provision for income taxes	<u>(8,279)</u>	<u>—</u>
Net loss	<u>\$ (2,150,059)</u>	<u>\$ (1,628,409)</u>
Weighted average number of common shares outstanding – basic and diluted	<u>39,042,142</u>	<u>34,937,077</u>
Net loss per common share - basic and diluted	<u>\$ (0.05)</u>	<u>\$ (0.05)</u>

See accompanying notes to consolidated financial statements.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Consolidated Statements of Stockholder Deficit

	Common Stock		Additional Paid-In Amount	Stock Payable	Accumulated Deficit	Total Deficit
	Shares	Amount				
Balance at January 1, 2015	31,389,000	\$ 31,389	\$4,673,497	\$ 2,250	\$(5,256,677)	\$ (549,541)
Shares issued for cash	718,904	719	107,117			107,836
Shares issued for property purchase	6,000,000	6,000	474,000			480,000
Warrants issued with notes payable			3,054			1,265
Stock option compensation			302,189			302,189
Shares issued for settlement of notes payable	681,100	681	101,483			102,164
Shares issued for share subscription settlement	25,000	25	3,725	(2,250)		1,500
Shares issued upon conversion of debt			25,495			25,495
Net loss					(1,628,409)	(1,628,409)
Balance at December 31, 2015	38,814,004	\$ 38,814	\$5,690,560	—	\$(6,885,086)	\$(1,155,712)
Shares issued for cash	500,000	500	99,500			100,000
Net loss					(2,150,059)	(2,150,059)
Balance at December 31, 2016	39,314,004	\$ 39,314	\$5,790,060	\$ —	\$(9,035,145)	\$(3,205,771)

See accompanying notes to consolidated financial statements.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Consolidated Statements of Cash Flows

	For the years Ended December 31,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (2,150,059)	\$ (1,628,409)
Depreciation, amortization and accretion	23,284	20,226
Amortization of debt discount	5,751	10,291
Gain – notes payable settlement	—	26,080
Executive stock based compensation expense	—	302,188
Changes in operating assets and liabilities:		
Decrease (Increase) in other receivable	12,200	(18,133)
Decrease in prepaid expenses	(3,566)	6,016
Increase in deposits	—	(205,000)
Increase in accounts payable and accrued liabilities	537,089	439,541
Increase in accrued interest payable	545,354	227,945
Net cash used in operating activities	<u>(1,028,947)</u>	<u>(819,253)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Exploration and development of oil and gas properties	(2,032,760)	(930,426)
Property Acquisitions	—	(2,000,000)
Purchase of equipment	(12,500)	—
Net cash used in investing activities	<u>(2,045,260)</u>	<u>(2,930,426)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from sale of common stock, net of costs	100,000	239,244
Proceeds from sale of preferred stock, net of costs	3,014,600	
Proceeds from notes payable	68,736	3,500,000
Repayments of notes payable	(66,891)	(113,308)
Net cash provided by financing activities	<u>3,116,445</u>	<u>3,625,936</u>
Net increase (decrease) in cash	42,238	(123,743)
Cash at beginning of year	146,555	270,298
Cash at end of year	<u>\$ 188,793</u>	<u>\$ 146,555</u>
Supplemental disclosures of cash flow information:		
Interest paid	\$ 5,584	\$ (651)
Income taxes paid	8,279	—
Non-cash investing and financing activities:		
Financing of insurance	\$ 68,736	\$ 62,548
Issuance of common stock as part of oil and gas property acquisition	—	480,000
Conversion of debt to equity	3,500,000	25,495
Issuance of common stock for settlement of notes payable and accrued interest	—	102,164
Asset retirement obligation	12,264	146,720

See accompanying notes to consolidated financial statements.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies

Organization

Citadel Exploration, Inc. ("Citadel Inc") was incorporated on December 17, 2009 in the State of Nevada originally under the name Subprime Advantage, Inc. On March 2, 2011, the Company changed its name from Subprime Advantage, Inc. to Citadel Exploration, Inc.

On May 3, 2011, Citadel Inc completed the acquisition of 100% interest in Citadel Exploration, LLC, a California limited liability company, ("Citadel LLC") pursuant to a Membership Purchase Agreement (the "MPA"). Under the MPA, Citadel Inc issued 14,000,000 shares of its common stock an individual in exchange for a 100% interest in Citadel LLC. Additionally under the MPA, the former officers and directors of Citadel Inc agreed to cancel 7,696,000 shares of its common stock. For accounting purposes, the acquisition of the Citadel LLC by Citadel Inc has been accounted for as a recapitalization, similar to a reverse acquisition except no goodwill is recorded, whereby the private company, Citadel LLC, in substance acquired a non-operational public company (Citadel Inc) with nominal assets and liabilities for the purpose of becoming a public company. Accordingly, Citadel LLC are considered the acquirer for accounting purposes and thus, the historical financials are primarily that of Citadel LLC. As a result of this transaction, Citadel Inc changed its business direction and is now involved in the acquisition and development of oil and gas resources in California. Citadel LLC was incorporated on November 6, 2006 (Date of Inception) and accordingly, the accompanying consolidated financial statements are from the Date of Inception of Citadel LLC through ending reporting periods reflected.

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to exploration stage enterprises, and are expressed in U.S. dollars. The Company's fiscal year end is December 31.

Principles of consolidation

For the years ended December 31, 2016 and 2015, 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.

Assumptions, Judgments and Estimates

In the course of preparing the consolidated financial statements, management makes various assumptions, judgments and estimates to determine the reported amounts of assets, liabilities, revenues and expenses, and in the disclosures of commitments and contingencies. Changes in these assumptions, judgments, and estimates will occur as a result of the passage of time and the occurrence of future events and, accordingly, actual results could differ from amounts previously established.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Assumptions, Judgments and Estimates (continued)

The more significant areas requiring the use of assumptions, judgments, and estimates include: (1) oil and natural gas reserves; (2) cash flow estimates used in impairment tests of long-lived assets; (3) depreciation, depletion and amortization; (4) asset retirement obligations; (5) assigning fair value and allocating purchase price in connection with business combinations; (6) income taxes; (7) valuation of derivative instruments; and (8) accrued revenue and related receivables. Although management believes these estimates are reasonable, actual results could differ from these estimates.

Fair value of financial instruments

Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of December 31, 2016 and 2015. See Footnote No. 13, “Fair Value of Financial Instruments,” for further information. The respective carrying value of certain on-balance-sheet financial instruments approximated their fair values. These financial instruments include cash, prepaid expenses and accounts payable. Fair values were assumed to approximate carrying values for payables because they are short term in nature and their carrying amounts approximate fair values or they are payable on demand.

Level 1: The preferred inputs to valuation efforts are “quoted prices in active markets for identical assets or liabilities,” with the caveat that the reporting entity must have access to that market. Information at this level is based on direct observations of transactions involving the same assets and liabilities, not assumptions, and thus offers superior reliability. However, relatively few items, especially physical assets, actually trade in active markets.

Level 2: FASB acknowledged that active markets for identical assets and liabilities are relatively uncommon and, even when they do exist, they may be too thin to provide reliable information. To deal with this shortage of direct data, the board provided a second level of inputs that can be applied in three situations.

Level 3: If inputs from levels 1 and 2 are not available, FASB acknowledges that fair value measures of many assets and liabilities are less precise. The board describes Level 3 inputs as “unobservable,” and limits their use by saying they “shall be used to measure fair value to the extent that observable inputs are not available.” This category allows “for situations in which there is little, if any, market activity for the asset or liability at the measurement date”. Earlier in the standard, FASB explains that “observable inputs” are gathered from sources other than the reporting company and that they are expected to reflect assumptions made by market participants.

Inventories

Materials and supplies are valued at weighted-average cost and are reviewed periodically for obsolescence. Finished goods include oil and natural gas products, which are valued at the lower of cost or market.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Oil and Natural Gas Properties

Effective, January 1, 2013, the Company changed its policy to account for its oil and natural gas exploration and development costs using the successful efforts method. The Company evaluated the impact on the prior periods and there were no material changes to the balance sheet as a result of the change in accounting policy.

Exploratory well costs are capitalized pending further evaluation of whether economically recoverable reserves have been found.

Oil and Natural Gas Properties (continued)

If economically recoverable reserves are not found, exploratory well costs are expensed as dry holes. All exploratory wells are evaluated for economic viability within one year of well completion, and the related capitalized costs are reviewed quarterly. Exploratory wells that discover potentially economic reserves in areas where a major capital expenditure would be required before production could begin and where the economic viability of that major capital expenditure depends upon the successful completion of further exploratory work in the area remain capitalized if the well finds a sufficient quantity of reserves to justify its completion as a producing well and the Company is making sufficient progress assessing the reserves and the economic and operating viability of the project.

The costs of development wells are capitalized whether productive or nonproductive. We review our oil and natural gas producing properties for impairment on a field-by-field basis whenever events or changes in circumstances indicate that the carrying amount of such properties may not be recoverable. If the sum of the expected undiscounted future cash flows from the use of the asset and its eventual disposition is less than the carrying amount of the asset, an impairment charge is recorded based on the fair value of the asset. This may occur if a field contains lower than anticipated reserves or if commodity prices fall below a level that significantly effects anticipated future cash flows on the field. The fair value measurement used in the impairment test is generally calculated with a discounted cash flow model using several Level 3 inputs which are based upon estimates, the most significant of which is the estimate of net proved reserves. There are numerous uncertainties inherent in estimating quantities of proved reserves and in projecting future rates of production and timing of development expenditures, including many factors beyond our control. Reserve engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact manner, and the accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. The quantities of oil and natural gas that are ultimately recovered, production and operating costs, the amount and timing of future development expenditures and future oil and natural gas sales prices may all differ from those assumed in these estimates.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Property, Plant and Equipment

The Company records all property and equipment at cost less accumulated depreciation. Improvements are capitalized while repairs and maintenance costs are expensed as incurred. Depreciation is calculated on a straight-line basis over estimated useful lives ranging from 5 to 30 years for buildings and improvements and 3 to 10 years for machinery and equipment. Leasehold improvements include the cost of the Company's internal development and construction department. The Company capitalizes the costs associated with the development of the Company's website pursuant to ASC Topic 350.

Stock-based compensation

The Company records stock based compensation in accordance with the guidance in ASC Topic 505 and 718 which requires the Company to recognize expenses 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.

Stock-based compensation (continued)

The Company recognizes the cost of all share-based awards on a graded vesting basis over the vesting period of the award.

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from other than employees in accordance with FASB ASC 718-10 and the conclusions reached by the FASB ASC 505-50. Costs are measured at the estimated fair market value of the consideration received or the estimated fair value of the equity instruments issued, whichever is more reliably measurable. The value of equity instruments issued for consideration other than employee services is determined on the earliest of a performance commitment or completion of performance by the provider of goods or services as defined by FASB ASC 505-50.

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.

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.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Concentrations of credit risk

Financial instruments that subject the Company to credit risk could consist of cash balances maintained in excess of federal depository insurance limits. The Company maintains its cash and cash equivalent balances with high credit quality financial institutions. At times, cash and cash equivalent balances may be in excess of Federal Deposit Insurance Corporation limits. To date, the Company has not experienced any such losses.

Restricted cash

The Company has three bonds at financial institutions to meet financial bonding requirements in the state of California. As of December 31, 2016, restricted cash totaled \$245,000.

Debt discount

The Company records debt discount as a contra liability account and is presented net of the associated note payable. The discount is amortized over the life on the note payable using the straight line method because the straight line method approximates the effective interest method.

Revenue Recognition

Revenues associated with sales of oil are recognized when delivery has occurred and title has transferred, and if the collectability of the revenue is probable.

Asset Retirement Obligation

The Company's asset retirement obligations (AROs) relate to future costs associated with plugging and abandonment of oil wells, removal of equipment and facilities from leased acreage and returning such land to its original condition. The fair value of a liability for an ARO is recorded in the period in which it is incurred (typically when the asset is installed at the production location), and the cost of such liability increases the carrying amount of the related long-lived asset by the same amount. The liability is accreted each period through charges to depreciation, depletion and amortization expense, and the capitalized cost is depleted on a units-of-production basis over the proved developed reserves of the related asset. Revisions to estimated AROs result in adjustments to the related capitalized asset and corresponding liability.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Revenue & Expense Recognition

The Company utilizes accrual basis of accounting when measuring financial position and operating results. The accrual basis recognizes revenues and expenses in the accounting period in which those transactions, events, or circumstances occur (goods or services are received) and become measurable.

The Company recognizes oil 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.

The Company recognizes its expenses when the expenses are incurred, not necessarily when they are paid. Expenses are generally incurred when the company receives tangible goods or services are provided.

Lease operating expense

Operating expenses include field operating expenses, transportation expenses, compression charges, and an allocation of overhead that directly relates to production activities.

Depreciation, Depletion and Amortization

The provision for DD&A-oil and natural gas production is calculated on a field-by-field basis using the unit-of-production method. Projected future production rates, the timing of future capital expenditures as well as changes in commodity prices, may significantly impact estimated reserve quantities. Depreciation, depletion and amortization—oil and natural gas production is dependent upon our estimates of total proved and proved developed reserves, which estimates incorporate various assumptions and future projections. These estimates are subject to change as additional information and technologies become available. Accordingly, oil and natural gas quantities ultimately recovered and the timing of production may be substantially different than projected. Reduction in reserve estimates may result in increased depreciation, depletion and amortization oil and natural gas production, which in turn reduces net earnings. Changes in reserve estimates are applied on a prospective basis. Such a decline in reserves may result from lower commodity prices, which may make it uneconomic to drill for and produce higher costs fields.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Income taxes

The Company follows ASC Topic 740 for recording the provision for income taxes. Deferred tax assets and liabilities are computed based upon the difference between the consolidated financial statements and income tax basis of assets and liabilities using the enacted marginal tax rate applicable when the related asset or liability is expected to be realized or settled. Deferred income tax expenses or benefits are based on the changes in the asset or liability each period.

If available evidence suggests that it is more likely than not that some portion or all of the deferred tax assets will not be realized, a valuation allowance is required to reduce the deferred tax assets to the amount that is more likely than not to be realized. Future changes in such valuation allowance are included in the provision for deferred income taxes in the period of change.

Deferred income taxes may arise from temporary differences resulting from income and expense items reported for financial accounting and tax purposes in different periods. Deferred taxes are classified as current or non-current, depending on the classification of assets and liabilities to which they relate. Deferred taxes arising from temporary differences that are not related to an asset or liability are classified as current or non-current depending on the periods in which the temporary differences are expected to reverse. The net operating loss carryforward for the year ended December 31, 2016 is \$9,035,145 and the deferred tax asset is \$3,689,000. The Company maintains a full valuation allowance for the deferred tax asset of \$3,689,000.

The Company applies a more-likely-than-not recognition threshold for all tax uncertainties. ASC Topic 740 only allows the recognition of those tax benefits that have a greater than fifty percent likelihood of being sustained upon examination by the taxing authorities. As of December 31, 2016 and 2015, the Company reviewed its tax positions and determined there were no outstanding, or retroactive tax positions with less than a 50% likelihood of being sustained upon examination by the taxing authorities, therefore this standard has not had a material effect on the Company.

The Company does not anticipate any significant changes to its total unrecognized tax benefits within the next 12 months.

The Company classifies tax-related penalties and net interest as income tax expense. As of December 31, 2016 and 2015, no income tax expense has been recorded.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Long-lived Assets

In accordance with the Financial Accounting Standards Board ("FASB") Accounts Standard Codification (ASC) ASC 360-10, "Property, Plant and Equipment," the carrying value of intangible assets and other long-lived assets is reviewed on a regular basis for the existence of facts or circumstances that may suggest impairment. Proved oil properties are reviewed for impairment on a field-by-field basis, annually or when events and circumstances indicate a possible decline in the recoverability of the carrying amount of such property. The Company estimates the expected future cash flows of its oil properties and compares these undiscounted cash flows to the carrying amount of the oil properties to determine if the carrying amount is recoverable. If the carrying amount exceeds the estimated undiscounted future cash flows, the Company will write down the carrying amount of the oil properties to fair value.

Long-lived Assets (continued)

The factors used to determine fair value include, but are not limited to, estimates of reserves, future commodity prices, future production estimates, estimated future capital expenditures, and discount rates commensurate with the risk associated with realizing the projected cash flows.

Unproved oil and natural gas properties are periodically assessed for impairment on a project-by-project basis. The impairment assessment is affected by the results of exploration activities, commodity price outlooks, planned future sales or expiration of all or a portion of such projects. If the quantity of potential reserves determined by such evaluations is not sufficient to fully recover the cost invested in each project, the Company will recognize an impairment loss at that time.

Recent pronouncements

The Company has evaluated the recent accounting pronouncements through March 2017 and believes that none of them will have a material effect on the company's consolidated financial statements.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated 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 significant 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 a net loss for period ended December 31, 2016 of \$2,150,059. In addition, the Company's exploration 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 – Prepaid Expenses

As of December 31, 2016 and 2015, the Company had prepaid insurance totaling \$33,436 and \$29,870 respectively. The prepaid insurance will be expensed on a straight line basis over the remaining life of the insurance policies. During the years ended December 31, 2016 and 2015, the Company recorded \$87,788 and \$115,410 of insurance expenses. As of December 31, 2016 and 2015, the Company had a prepaid deposit of \$5,000 and \$5,000 respectively for leased office space.

Note 4 – Oil and Gas Properties, Buildings, and Equipment

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

	<u>2016</u>	<u>2015</u>
Oil and Natural Gas:		
Proved properties	\$ 3,751,401	\$ 1,734,223
Unproved properties	1,170,000	2,444,608
Facilities	1,443,060	
	<u>6,364,461</u>	<u>4,178,831</u>
Less oil property impairment	(140,606)	—
Less accumulated depreciation, depletion, and amortization	(14,309)	(5,524)
	<u>\$ 6,209,546</u>	<u>\$ 4,173,307</u>

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 4 – Oil and Gas Properties, Buildings, and Equipment (Continued)

Project Indian

Project Indian is located in the Bitterwater sub-basin of the Salinas Basin, north of the giant San Ardo Field. Citadel currently owns a 100% working interest at Project Indian. In July of 2014 Citadel ended its prior joint venture with Sojitz Energy Ventures. There is a 20% royalty on the property owned by Vintage Petroleum, a wholly owned subsidiary of Occidental Petroleum Inc. In November of 2014 Occidental Petroleum Inc. spun off its California assets into a new public company called California Resources Corporation, which is listed on the New York Stock Exchange under the ticker CRC. CRC is now the mineral owner at Project Indian. In January of 2014, Citadel drilled and completed the first well at Project Indian, the Indian #1-15, and conducted a successful steam cycle in June of 2014. The Indian #1-15 then produced 3 to 7 barrels per day over several weeks before production halted because the well was shut-in by an order of the Superior Court of the State of California-County of Monterey entitled Center for Biological Diversity v. San Benito County Case no. M123956 (hereinafter the “Case”). In the Case, the Center for Biological Diversity, a non-governmental entity, petitioned the Court over the approval of Project Indian by the County of San Benito on a unanimous, 5-0 vote. Specifically, it argued that Project Indian required an Environmental Impact Report and not a Mitigated Negative Declaration which was the standard of environmental due diligence required by the County before its unanimous approval of the Project. The Court approved the petition in a judgment entered on September 4, 2014, and ruled that Citadel was required to obtain an environmental impact report before commencing further at Project Indian.

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

Management has determined to shift capital resources to concentrate on drill ready projects that will immediately produce revenue. Consequently, the Company has suspended future capital expenditures related to Project Indian. Management impaired Project Indian in the fourth quarter of 2014 with a value of \$1,420,574. The Company maintains its lease rights, takings claims, and no waiver of any right is intended by taking the foregoing impairment. Any action taken by the Company with respect to Project Indian in the near future, if any, will likely only be taken to preserve or advance the Company’s aforementioned legal rights and interests.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 4 – Oil and Gas Properties, Buildings, and Equipment (Continued)

Yowlumne

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

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

In December of 2014, Citadel began a work-over on the Yowlumne #2-26 well including installation of a new pump in February of 2015. The well has been producing approximately 20- 25 barrels per day (32 degree API quality) since the beginning of March. In June the well’s pump had a mechanical issue, the company performed well maintenance operations on the #2-26 well in August, which returned the well to production at approximately 20-25 barrels per day. Citadel anticipates returning the well to production in the second or third quarter of 2017. Citadel is in the final stages of the CEQA process to permit two additional exploration wells on the Yowlumne acreage. Recent regulatory changes, including SB4 the State of California’s bill on fracking have delayed the final approval of our CEQA application. As such we do not expect to have these prospects permitted until 2017, at which time we will determine when to drill. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 15,000 feet. Citadel currently has a 75% working interest in these exploration prospects and is the operator.

As an annual process, Citadel reviewed the field to determine if asset impairment is required. If the carrying amount of the asset exceeds the sum of the undiscounted estimated future net cash flows, the Company will recognize impairment expense equal to the difference between the carrying value and the fair value of the asset, which is estimated to be the expected present value of discounted future net cash flows from proved reserves, utilizing a risk-free rate of return. This process includes a projection of future oil and natural gas reserves that will be produced from a field, the timing of this future production, future costs to produce the oil and natural gas, and future inflation levels. Citadel cannot predict the amount of impairment charges that may be recorded in the future. During the year ended December 31, 2016, the Company reduced the asset value by \$140,606 as a result of low oil prices.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 4 – Oil and Gas Properties, Buildings, and Equipment (Continued)

Kern Bluff Oil Field

The following table summarizes the consideration paid to the sellers and the amounts of the assets acquired and liabilities assumed in the Kern Bluff Acquisitions:

Consideration paid to sellers:	
Cash consideration	\$ 2,000,000
Stock consideration	480,000
	<u>2,480,000</u>
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Proved developed and undeveloped properties	2,370,000
Other assets acquired	110,000
Asset retirement obligation	146,720
Other liabilities assumed	-
Total identifiable net assets	\$ <u>2,626,720</u>

In July of 2015, Citadel purchased approximately 1,100 acres encompassing the Kern Bluff Oil Field for \$2,000,000 in cash and 6,000,000 shares of its common stock valued at \$480,000, based on price per share on date of sale. The seller also retained a royalty that varies on a lease by lease basis; Citadel has 100% working interest in the field with an 80% net revenue interest. This field was discovered in 1944 by Gulf Oil. Gulf drilled approximately 169 wells in the field in the 1970's and 1980's recovering twelve million barrels of oil, primarily from the Santa Margarita formation located at depths in the 900 to 1,100 foot range. Analogous fields in the area have achieved recovery levels in the 40-90% range. Citadel believes it can recover 20-40% of the remaining OOIP, through down spacing, horizontal development, cyclic steam injection and exploitation of shallower by passed zones.

In December of 2015, Citadel shifted its CAPEX focus to remediation of the existing acquired facilities. At the time of purchase, the oil at Kern Bluff was being processed by temporary facilities installed by the previous owner. As production increased in September, it quickly became apparent that these facilities were not capable of processing the additional volumes of oil and water being produced. The existing permanent facilities were built in the 1970's by Gulf Oil and require extensive remediation including new pipe, valves, flanges and tank repair. In order to facilitate the remediation, Citadel elected to shut down the eight producing wells in early January. Citadel completed facility remediation in July of 2016; the facilities are estimated to have production capability of 500 barrels per day of oil. Citadel returned existing wells to production and then drilled three new wells during the third quarter of 2016.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 5 – Income Taxes

The (benefit) provision for income taxes from continuing operations consists of the following (in thousands):

	Year Ended December 31,	
	2016	2015
Current:		
Federal	\$ —	\$ —
State	8	2
	<u>8</u>	<u>2</u>
Deferred:		
Federal	—	—
State	—	—
	<u>—</u>	<u>—</u>
Total	<u>\$ 8</u>	<u>\$ 2</u>

The components of the net deferred income tax liabilities consist of the following:

	Year Ended December 31,	
	2016	2015
Deferred income tax assets:		
Equity and deferred compensation	272	174
Net operating loss	2,728	2,092
State net operating loss carry forward	689	485
Other, net	—	—
Total deferred tax assets	3,689	2,752
Valuation allowance	(3,628)	(2,422)
	<u>61</u>	<u>330</u>
Deferred income tax liabilities:		
Depreciation and depletion	(61)	(330)
Net deferred income tax liabilities	<u>\$ —</u>	<u>\$ —</u>

As of December 31, 2016, we had approximately \$9,035,000 in net operating loss carryforwards for each federal and state income tax purposes. In assessing the realizability of the deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Management has concluded that there is no assurance that the company will have taxable income in the future; therefore 100% of the deferred income tax assets is not recognized. We consider the scheduled reversal of deferred tax assets, the level of historical taxable income and tax planning strategies in making the assessment of the realizability of deferred tax assets. We have identified the U.S. federal and California as our "major" tax jurisdiction. With limited exceptions, we remain subject to IRS examination of our income tax returns filed within the last three (3) years, and to California Franchise Tax Board examination of our income tax returns filed within the last four (4) years.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 6 – Equipment

Equipment as of December 31, 2016 and 2015 are as follows:

	2016	2015
Vehicles	\$ 46,072	\$ 33,572
Website	1,375	1,375
Furniture	10,000	10,000
Computer Equipment	8,165	8,165
Less: Accumulated depreciation	(47,083)	(39,252)
	<u>\$ 18,530</u>	<u>\$ 13,860</u>

Depreciation expense for the years ended December 31, 2016 and 2015 was \$7,831 and \$12,067.

Note 7 – Notes Payable

Notes payable consists of the following:

	December 31, 2016	December 31, 2015
Note payable to an entity for the financing of insurance premiums, unsecured; 7.75% interest, due March 2017	\$ 26,880	\$ —
Note payable to an entity for the financing of insurance premiums, unsecured; 7.44% interest, due March 2016	—	25,034
Two notes payable to investors, unsecured, 10% interest; due March 31, 2017	500,000	500,000
Notes Payable – Total	<u>\$ 526,880</u>	<u>\$ 525,034</u>
Notes Payable, Related Party		
Term loan with a related party investor executed July 30, 2015, unsecured, 10% interest; due July 30, 2016	\$ —	\$ 3,500,000
Total – Notes Payable & Notes Payable, Related Party	<u>\$ 526,880</u>	<u>\$ 4,025,034</u>

Interest expense for the year ended December 31, 2016 was \$572,025. Of that amount \$566,273 relates to preferred stock, notes payable and insurance financing and \$5,751 is amortization of debt discount. Interest expense for the year ended December 31, 2015 was \$220,413. Of that amount \$209,168 relates to notes payable and insurance financing and \$10,291 is amortization of debt discount.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 8 – Production Payment Liability

In December 2014, the Company entered into a financing agreement with two related party entities. The Company received \$300,000 in total from both entities to fund costs of the Yowlumne 2-26 well recompletion. In return for the funds received, the two entities will receive a combined 75% of the net revenue from the well until the \$300,000 is repaid. At the time of repayment, the entities will own a total 3% overriding royalty on the well. This liability is completely dependent on the well generating revenue.

If the well fails to generate enough revenue to repay the \$300,000, Citadel is not responsible for the unpaid amount. According to ASC 932-470-25 Section B, Funds advanced to an operator that are repayable in cash out of the proceeds from a specified share of future production of a producing property, until the amount advanced \$300,000 is paid in full, shall be accounted for as a borrowing. The advance is a payable for the recipient of the cash invested. Given the well is not currently on production coupled with the high cost of water disposal, we believe it will take more than two years for payback to occur; therefore this has been classified as a long-term payable.

Note 9 – Asset Retirement Obligations (AROs)

The Company's ARO relates to future costs associated with the plugging and abandonment of oil and natural gas wells, removal of equipment facilities from leased acreage and land restoration in accordance with applicable local, state and federal laws. The discounted fair value of an ARO liability is required to be recognized in the period in which it is incurred, with the associated asset retirement cost capitalized as part of the carrying cost of the oil and natural gas asset. In periods subsequent to the initial measurement of the ARO, the Company must recognize period-to-period changes in the liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. The increases in the ARO liability due to the passage of time impact net earnings as accretion expense. The related capital cost, including revisions thereto, is charged to expense through depreciation, depletion and amortization of oil and natural gas production over the life of the oil and natural gas field.

The following table summarizes the activity for the Company's abandonment obligations:

	Year Ended December 31,	
	2016	2015
Beginning balance at January 1	\$ 198,279	\$ 48,923
Liabilities incurred from property acquisition	12,264	146,720
Accretion expense	6,669	2,636
Ending balance at December 31	<u>\$ 217,212</u>	<u>\$ 198,279</u>

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 10 – Stockholders’ Deficit

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

In March of 2015, the Company approved the issuance of 1,400,000 common stock shares for the conversion of a \$100,000 promissory note, plus accrued interest of \$2,164 and an additional capital investment of \$107,836, all at fair value of \$0.15 per share.

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

In July of 2015, the Company issued 6,000,000 shares of common stock at fair value and paid \$1,900,000 in cash for the Kern Bluff Oil Field. The Company had paid a \$100,000 deposit on the property in May of 2015, upon execution of a letter of intent (LOI) on the field.

In March of 2016, the Company approved the sale of up to 250,000 shares of Series A Convertible Participating Preferred Stock. The Company sold 175,000 shares of Series A Convertible Participating Preferred Stock to convert its \$3,500,000 related party note payable to preferred stock. In addition, the Company has sold 21,250 shares of Series A Convertible Participating Preferred Stock for cash in the amount of \$425,000 through March 31, 2016.

In June of 2016, the Company sold 50,000 shares of Series A Convertible Participating Preferred Stock for cash in the amount of \$1,000,000.

In September of 2016, the Company sold 26,500 shares of Series A Convertible Participating Preferred Stock for cash in the amount of \$530,000. The Company issued 500,000 shares of common stock for cash in the amount of \$100,000.

In October of 2016, the Company sold 10,350 shares of Series A Convertible Participating Preferred Stock for cash in the amount of \$207,000.

In November of 2016, the Company sold 29,330 shares of Series A Convertible Participating Preferred Stock for cash in the amount of \$586,600.

In December of 2016, the Company sold 13,300 shares of Series A Convertible Participating Preferred Stock for cash in the amount of \$266,000.

In December of 2016, the Company was notified by its transfer agent, that prior to issuing its Series A Preferred stock, the Company was required to file a 14c with the Securities and Exchange Commission to authorize the issuance of previously sold Series A Preferred Stock. This delay in issuance of Series A Preferred required the Company to classify the Series A Preferred as a liability until the Series A Preferred is issued, which is expected in the first quarter of 2017. This will also require the Company to restate prior periods of their form 10Q, in which Series A Preferred Shares were sold, but not issued deeming them a liability.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 11 – Stock Option Plan

On July 29, 2015 as approved by the Board of Directors, the Company granted 4,700,000 stock options to three members of management and to three members of the Board of Directors. These options vest over a three year period, at \$0.15 per share for a term of seven years. The total fair value of these options at the date of grant was estimated to be \$376,490 and was determined using the Black Scholes option pricing model with an expected life of 7 years, risk free interest rate of 1.872%, dividend yield of 0%, and expected volatility of 333%. During the year ended December 31, 2015, \$152,198 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 December 31, 2016 and changes during the period ended on that date:

	Number of Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Life (Years)
Outstanding at January 1, 2015	4,800,000	\$ 0.26	\$ —	5.65
Exercisable at January 1, 2015	3,200,000	\$ 0.22	\$ —	3.79
Granted	4,700,000	\$ 0.15	\$ —	6.58
Exercised	—	\$ 0.00	\$ —	—
Cancelled	—	\$ 0.00	\$ —	—
Outstanding at December 31, 2015	9,500,000	\$ 0.20	\$ —	5.26
Exercisable at December 31, 2015	7,902,000	\$ 0.20	\$ —	4.55
Granted		\$ 0.00	\$ —	
Exercised	—	\$ 0.00	\$ —	—
Cancelled	—	\$ 0.00	\$ —	—
Outstanding at December 31, 2016	9,500,000	\$ 0.20	\$ —	5.26
Exercisable at December 31, 2016	7,902,000	\$ 0.20	\$ —	4.00

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 12 – Warrants

In March 2014, the Company closed on a \$500,000 180-day bridge loan with two investors. The loans bear interest of 10%. Additionally, the investors were granted a total of 500,000 stock warrants to purchase stock at \$1.00 per share for a period of two years valued at \$147,102. The total fair value of these warrant at the date of grant was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.45%, a dividend yield of 0% and expected volatility of 333%. In September of 2014, the maturity date of this bridge loan was extended by 30 days; in return the exercise price of the warrant was reduced to \$0.34 per share, with the original two year term remaining. Due to the change in the terms of the warrants, the Company recalculated the value of the warrants to be \$85,325. Accordingly, the Company recognized a gain on the extinguishment of \$73,573. In December of 2015, the maturity date of this bridge loan was extended until September 30, 2016, in return the exercise price of the warrant was reduced to \$0.20 and the term of the warrants also extended to until September 30, 2016. At September 30, 2016, the maturity date was further extended to March 31, 2017. The exercise price of the warrant did not change during the extension to March 31, 2016.

The following is a summary of the status of all of the Company's stock warrants as of December 31, 2016 and changes during the period ended on that date:

	Number of Warrants	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)
Outstanding at January 1, 2015	500,000	\$ 0.34	1.33
Granted	—	\$ 0.00	—
Exercised	—	\$ 0.00	—
Cancelled	—	\$ 0.00	—
Outstanding at December 31, 2015	500,000	\$ 0.20	0.75
Exercisable at December 31, 2015	500,000	\$ 0.20	0.75
Granted	—	\$ 0.00	—
Exercised	—	\$ 0.00	—
Cancelled	—	\$ 0.00	—
Outstanding at December 31, 2016	500,000	\$ 0.20	0.25
Exercisable at December 31, 2016	500,000	\$ 0.20	0.25

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 13 – Fair Value Measurement

Liabilities Measured at Fair Value on a Recurring Basis

The following table sets forth by level within the fair value hierarchy the Company's net derivative liabilities that were measured at fair value on a recurring basis as of December 31, 2016 and 2015:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Derivatives liability, net				
December 31, 2016	\$ —	\$ —	\$ —	\$ —
December 31, 2015	\$ —	\$ —	\$ —	\$ —

Changes in Level 3 Fair Value Measurements

The table below includes a rollforward of amounts included in the Company's Balance Sheet (including the change in fair value) for financial instruments classified by the Company within Level 3 of the fair value hierarchy. When a determination is made to classify a financial instrument within Level 3 of the fair value hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement.

Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources).

	<u>Year Ended December 31</u>	
	<u>2016</u>	<u>2015</u>
Fair value liability (asset), beginning of period	\$ —	\$ 13,308
Transfer out of Level 3(1)	\$ —	\$ (13,308)
Realized and unrealized (gain) loss included in earnings	\$ —	\$ —
Unrealized loss included in derivative liability	\$ —	\$ —
Settlements	\$ —	\$ —
Fair value liability, end of period	<u>\$ —</u>	<u>\$ —</u>

(1) During the first quarter of 2015, the derivative liability was converted into shares of stock and these instruments were transferred to level 1. The inputs used to value common stock are defined as unadjusted quoted prices in active markets for identical assets or liabilities.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 14 – Related Party Transactions

In December 2014, the Company entered into an agreement with Jim Walesa and Cibolo Creek Partners to fund \$300,000 towards the Yowlumne #2-26 recompletion. In this agreement Mr. Walesa and Cibolo Creek will receive 75% of the net revenue after expenses, until they have received \$300,000 in payment. Upon full repayment, Mr. Walesa and Cibolo Creek will receive a 3% royalty on the well. Mr. Walesa is currently on the Board of Directors of Citadel and a member of Cibolo Creek Partners.

In July of 2015, the Company entered into a \$3,500,000 one year term loan with Cibolo Creek Partners for the purchase and development of the Kern Bluff Oil Field. Mr. Walesa is currently on the Board of Directors of Citadel and a member of Cibolo Creek Partners.

On September 1, 2015, the Company entered into a three year employment agreement with its CEO. The annual salary for the first year is \$240,000, then in the second year it increases to \$300,000, and in the third year it increases to \$360,000.

Additionally, the officer received 1,500,000 stock options recorded at a fair value of \$120,156. During the year ended December 31, 2015, the Company recorded executive compensation totaling \$240,000.

On September 1, 2015, the Company entered into a three year employment agreement with its CFO. The annual salary for the first year is \$240,000, then in the second year it increases to \$300,000, and in the third year it increases to \$360,000.

Additionally, the officer received 1,500,000 stock options recorded at a fair value of \$120,156. During the year ended December 31, 2015, the Company recorded executive compensation totaling \$240,000.

During the year ended December 31, 2015 and December 31, 2016, the Company made the following purchases in the amount of \$227,903 and 364,253, respectively, from an entity considered a related party for oil field equipment and services from Grey Energy. Grey Energy is owned by James Borgna, who is a member of our Board of Directors.

Table of Contents

CITADEL EXPLORATION, INC. Notes to Consolidated Financial Statements

Note 15 – Subsequent Events

In February of 2017, we sold an additional 5,000 shares of Series A Preferred Stock to Cibolo Creek Partners for cash proceeds of \$100,000.

In February of 2017, the company filed a 14C with the SEC approving the issuance of 500,000 shares of Series A Preferred, 500,000 shares of Series B Preferred and 500,000 shares of Series C Preferred. Additionally the Company increased its total authorized common shares from 100,000,000 to 300,000,000.

In March of 2017, we issued 335,365 shares of Series A Preferred Shares to investors that subscribed to the offering in 2016.

In March of 2017, we issued 5,000 shares of Series A Preferred Shares to investors that subscribed to the offering in 2017.

In March of 2017, we paid a special common stock dividend to holders of the Series A Preferred Stock as accrued interest during the offering period of the Series A Preferred. Series A Preferred investors received 2,034,002 shares valued at \$0.20 per share equal to the conversion price of the Series A Preferred.

Note 16 - Supplemental Information about Oil & Natural Gas Producing Activities (Unaudited)

The Company's oil and natural gas reserves are attributable solely to properties within the United States.

Capitalized Costs

	December 31,	
	2016	2015
Oil and natural gas properties:	(in thousands)	
Proved properties	\$ 3,751	\$ 1,734
Unproved properties	1,170	2,445
Facilities	1,443	—
Total oil and natural gas properties	6,364	4,179
Less oil property impairment	(141)	
Less accumulated depreciation, depletion and amortization	(14)	(6)
Net oil and natural gas properties capitalized	\$ 6,209	\$ 4,173

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 16 - Supplemental Information about Oil & Natural Gas Producing Activities (Unaudited)(Continued)

Costs Incurred for Oil and Natural Gas Producing Activities

	Year Ended December 31,		
	2016	2015	2014
Acquisition costs:		(in thousands)	
Proved properties	\$ —	\$ 1,200	\$ —
Unproved properties	—	1,170	391
Development costs	2,171	944	611
Total	<u>\$ 2,171</u>	<u>\$ 3,314</u>	<u>\$ 1,002</u>

Reserve Quantity Information

The following information represents estimates of the Company's proved reserves as of December 31, 2016, which have been prepared and presented under SEC rules. These rules require SEC reporting companies to prepare their reserve estimates using specified reserve definitions and pricing based on a 12-month unweighted average of the first-day-of-the-month pricing. The pricing that was used for estimates of the Company's reserves as of December 31, 2016 was based on an unweighted average 12-month average WTI posted price per Bbl for oil as set forth in the following table:

	Year Ended December 31,			
	2016	2015	2014	
Oil (per Bbl)	\$ 35.53	\$ 44.62	\$	N/A

Subject to limited exceptions, proved undeveloped reserves may only be booked if they relate to wells scheduled to be drilled within five years of the date of booking. This requirement has limited, and may continue to limit, the Company's potential to record additional proved undeveloped reserves as it pursues its drilling program. Moreover, the Company may be required to write down its proved undeveloped reserves if it does not drill on those reserves within the required five-year timeframe. The Company does not have any proved undeveloped reserves which have remained undeveloped for five years or more.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 16 - Supplemental Information about Oil & Natural Gas Producing Activities (Unaudited)(Continued)

The Company's proved oil reserves are located in the United States in the San Joaquin Valley of California. Proved reserves were estimated in accordance with the guidelines established by the SEC and the FASB.

Oil reserve quantity estimates are subject to numerous uncertainties inherent in the estimation of quantities of proved reserves and in the projection of future rates of production and the timing of development expenditures. The accuracy of such estimates is a function of the quality of available data and of engineering and geological interpretation and judgment. Results of subsequent drilling, testing and production may cause either upward or downward revision of previous estimates.

Further, the volumes considered to be commercially recoverable fluctuate with changes in prices and operating costs. The Company emphasizes that reserve estimates are inherently imprecise and that estimates of new discoveries are more imprecise than those of currently producing oil and natural gas properties. Accordingly, these estimates are expected to change as additional information becomes available in the future.

The following table provides a roll forward of the total proved reserves for the years ended December 31, 2016, 2015, and 2014, as well as proved developed and proved undeveloped reserves at the beginning and end of each respective year:

	Year Ended December 31, 2016		
	Crude Oil (Bbls)	Natural Gas (Mcf)	Boe
		(in thousands)	
Proved Developed and Undeveloped Reserves:			
Beginning of the year	1,414	—	1,414
Extensions and discoveries	—	—	—
Revisions of previous estimates	(251)	—	(251)
Purchases of reserves in place		—	
Divestures of reserves in place	—	—	—
Production	(3)	—	(3)
End of the year	<u>1,160</u>	<u>—</u>	<u>1,160</u>
Proved Developed Reserves:			
Beginning of the year	358	—	358
End of the year	240	—	240
Proved Undeveloped Reserves:			
Beginning of the year	1,056	—	1,056
End of the year	920	—	920

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 16 - Supplemental Information about Oil & Natural Gas Producing Activities (Unaudited)(Continued)

	Year Ended December 31, 2015		
	Crude Oil	Natural Gas	Boe
	(Bbls)	(Mcf)	
	(in thousands)		
Proved Developed and Undeveloped Reserves:			
Beginning of the year	—	—	—
Extensions and discoveries	—	—	—
Revisions of previous estimates	—	—	—
Purchases of reserves in place	1,418	—	1,418
Divestures of reserves in place	—	—	—
Production	(4)	—	(4)
End of the year	1,414	—	1,414
Proved Developed Reserves:			
Beginning of the year	—	—	—
End of the year	358	—	358
Proved Undeveloped Reserves:			
Beginning of the year	—	—	—
End of the year	1,056	—	1,056
	Year Ended December 31, 2014		
	Crude Oil	Natural Gas	Boe
	(Bbls)	(Mcf)	
	(in thousands)		
Proved Developed and Undeveloped Reserves:			
Beginning of the year	—	—	—
Extensions and discoveries	—	—	—
Revisions of previous estimates	—	—	—
Purchases of reserves in place	—	—	—
Divestures of reserves in place	—	—	—
Production	—	—	—
End of the year	—	—	—
Proved Developed Reserves:			
Beginning of the year	—	—	—
End of the year	—	—	—
Proved Undeveloped Reserves:			
Beginning of the year	—	—	—
End of the year	—	—	—

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 16 - Supplemental Information about Oil & Natural Gas Producing Activities (Unaudited)(Continued)

Standardized Measure of Discounted Future Net Cash Flows

The standardized measure of discounted future net cash flows does not purport to be, nor should it be interpreted to present, the fair value of the oil and natural gas reserves of the property. An estimate of fair value would take into account, among other things, the recovery of reserves not presently classified as proved, the value of unproved properties, and consideration of expected future economic and operating conditions.

The estimates of future cash flows and future production and development costs as of December 31, 2016, 2015, and 2014 are based on the unweighted arithmetic average first-day-of-the-month price for the preceding 12-month period. Estimated future production of proved reserves and estimated future production and development costs of proved reserves are based on current costs and economic conditions. All wellhead prices are held flat over the forecast period for all reserve categories. The estimated future net cash flows are then discounted at a rate of 10%.

The standardized measure of discounted future net cash flows relating to proved oil and natural gas reserves is as follows:

	December 31,		
	2016	2015	2014
	(in thousands)		
Future cash inflows	\$ 41,220	\$ 63,111	\$ —
Future development costs	(8,785)	(13,141)	—
Future production costs	(25,567)	(34,494)	—
Future income tax expenses	(860)	(2,974)	—
Future net cash flows	6,008	12,502	—
10% discount to reflect timing of cash flows	(2,927)	(5,395)	—
Standardized measure of discounted future net cash flows	<u>\$ 3,081</u>	<u>\$ 7,107</u>	<u>\$ —</u>

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 16 - Supplemental Information about Oil & Natural Gas Producing Activities (Unaudited)(Continued)

In the foregoing determination of future cash inflows, sales prices used for oil and natural gas for December 31, 2016, 2015, and 2014, were estimated using the average price during the 12-month period, determined as the unweighted arithmetic average of the first-day-of-the-month price for each month. Prices were adjusted by lease for quality, transportation fees and regional price differentials. Future costs of developing and producing the proved gas and oil reserves reported at the end of each year shown were based on costs determined at each such year-end, assuming the continuation of existing economic conditions. Future income tax expenses are computed by applying the appropriate year-end statutory income tax rates to the estimated future pre-tax net cash flows relating to proved oil and natural gas reserves, less the tax bases of the properties involved. The future income tax expenses give effect to income tax deductions, credits, NOL's and allowances relating to the proved oil and gas reserves. All cash flow amounts, including income taxes, are discounted at 10%.

It is not intended that the FASB's standardized measure of discounted future net cash flows represent the fair market value the Company's proved reserves. The Company cautions that the disclosures shown are based on estimates of proved reserve quantities and future production schedules which are inherently imprecise and subject to revision, and the 10% discount rate is arbitrary. In addition, costs and prices as of the measurement date are used in the determinations, and no value may be assigned to probable or possible reserves.

[Table of Contents](#)

CITADEL EXPLORATION, INC.
Notes to Consolidated Financial Statements

Note 16 - Supplemental Information about Oil & Natural Gas Producing Activities (Unaudited)(Continued)

Changes in the standardized measure of discounted future net cash flows relating to proved oil and natural gas reserves are as follows:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Standardized measure of discounted future net cash flows at the beginning of the year	\$ 7,107	\$ —	\$ —
Sales of oil and natural gas, net of production costs	(5)	—	—
Purchase of minerals in place	—	7,107	—
Divestiture of minerals in place	—	—	—
Extensions and discoveries, net of future development costs	—	—	—
Previously estimated development costs incurred during the period	—	—	—
Net changes in prices and production costs	8,927	—	—
Changes in estimated future development costs	4,356	—	—
Revisions of previous quantity estimates	(21,886)	—	—
Accretion of discount	2,468	—	—
Net change in income taxes	2,114	—	—
Net changes in timing of production and other	—	—	—
Standardized measure of discounted future net cash flows at the end of the year	<u>\$ 3,081</u>	<u>\$ 7,107</u>	<u>\$ —</u>

**ESTIMATED RESERVES
AND
FUTURE NET INCOME
AS OF
DECEMBER 31, 2016**

**ATTRIBUTABLE TO CERTAIN
MINERAL AND LEASEHOLD INTERESTS OF
CITADEL EXPLORATION, INC.**

SEC PARAMETERS

PREPARED

MARCH 2017



**MHA Petroleum Consultants
4700 Stockdale Highway, Suite 110
Bakersfield, CA 93309**

**730 17th Street, Suite 410
Denver, CO 80202**



March 22, 2017

Citadel Exploration, Inc.
 Attention: Mr. Phil McPherson, CFO
 417 31st Street, Unit A
 Newport Beach, California 92663

Subject: Estimated Proved Reserves and Future Net Income as of December 31, 2016

Dear Mr. McPherson:

MHA Petroleum Consultants, LLC (MHA) prepared an estimate of the proved oil reserves, production and future net income as of December 31, 2016 attributable to certain leasehold interests of Citadel Exploration, Inc. (Citadel) located in the Kern Bluff oil field, Township 29 South, Range 29 East, MDB&M, Kern County, California. A map of the field is shown by **FIGURE 1**. The primary purpose of our evaluation report is to provide estimates of reserves information in support of Citadel's year-end reserves reporting requirements under U.S. Securities Regulation S-K and for other internal business and financial needs of Citadel.

The estimated net proved reserves and future net income are shown below.

Estimated Proved Reserves as of December 31, 2016 Consolidated Economic Summary – Before Income Tax (BIT) SEC Parameters							
Reserves Category	Net Reserves		Income Data (Before Taxes)				
	Crude Oil	Natural Gas	Future Net Revenue	Net Operating Expense ¹	Net Capital Expense	Undiscounted Net Cash Flow	Discounted Net Cash Flow @ 10%
	<i>MBbls</i>	<i>MMscf</i>	<i>M\$</i>	<i>M\$</i>	<i>M\$</i>	<i>M\$</i>	<i>M\$</i>
Proved Dev Producing	80.2	0.0	2,851.1	2,449.0	0.0	402.1	261.5
Proved Dev Behind Pipe	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Proved Dev Non-Producing	159.5	0.0	5,667.0	4,290.6	600.0	776.1	520.2
Proved Undeveloped	920.4	0.0	32,701.7	18,827.4	8,185.0	5,689.3	2,858.2
Total Proved	1,160.1	0.0	41,219.8	25,567.2	8,785.0	6,867.5	3,639.9

MBbls = Thousand barrels; MMscf = Million standard cubic feet; M\$ = Thousand US Dollars

¹ Net operating expenses include severance and ad valorem taxes

This report has been prepared in accordance with our understanding of the definitions and disclosure guidelines of the United States Securities and Exchange Commission (SEC) contained in Title 17, Code of Federal Regulations, Modernization of Oil and Gas Reporting, Final Rule released January 14, 2009 in the Federal Register (SEC regulations). The proved reserves included herein conform to the definitions as set forth in the SEC's Regulations Part 210.4-10(a) and are referred to as the SEC Parameters Case (SEC Case). The SEC definitions as set forth in the SEC's Regulations Part 210.4-10(a) are presented in **APPENDIX A**.

The future net revenue is based on net oil volume sold multiplied by anticipated price under existing economic conditions. Expenses include assessment and ad valorem taxes, and the normal cost of operating the wells. The SEC Case assumes constant oil price and constant (un-escalated) operating costs and expenses.

Certification

Results of this report are certified as independent, reasonable assessments of the oil and natural gas remaining to be produced as of December 31, 2016. MHA and its employees do not have any interest in these properties. MHA's compensation for this report is not contingent on the estimate of reserves or future income attributable to the properties. This report was completed at the request of Citadel and was prepared for the exclusive use and sole benefit of Citadel. We reviewed Citadel's Kern Bluff field reserves only in connection with the preparation of this report.

The estimated reserves and valuations presented in this report are based on reservoir engineering work performed by MHA. Citadel furnished MHA all of the accounts, records, and data required for this evaluation. MHA staff did not conduct a site inspection of the properties presented in this report. The ownership interests and other factual data provided to MHA by Citadel were accepted without independent verification.

Reserves Analysis

The reserves in this report are estimated using guidelines endorsed by the Society of Petroleum Engineers (SPE) and the Society of Petroleum Evaluation Engineers (SPEE) and in our opinion, the reserve estimates conform to the SEC regulations and requirements.

Oil and gas reserves, as considered in this report, are classified as proved reserves. Proved oil and gas reserves are the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in the future years from the known reservoirs under existing economic and operating conditions (i.e., prices and costs as of the date the estimate is made).

Proved developed oil and gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods (no major capital investment required). Proved developed reserves may be subcategorized as producing or non-producing. Proved developed producing reserves (PDP) are expected to be recovered from completion intervals that are open and producing at the time of the estimate.

Reserves subcategorized as proved developed non-producing (PDNP) include shut-in and behind-pipe reserves (PDBP). Shut-in reserves are expected to be recovered from completion intervals which are open at the time of the estimate but which have not started producing, or wells not capable of production for mechanical reasons or waiting on stimulation treatments. Behind-pipe reserves are expected to be recovered from zones in existing wells, which will require additional completion work or future recompletion prior to the start of production. The PDNP reserves in this report are assigned to inactive wells which are proposed to be returned-to-production (RTP) in the Santa Margarita sands.

Proved undeveloped (PUD) oil and gas reserves are reserves expected to be recovered from new wells on undrilled acreage, from deepening existing wells to a different reservoir, or from existing wells where a relatively major expenditure is required for new equipment and/or recompletion. In this report, proved undeveloped reserves are assigned to infill drilling locations directly offsetting oil-productive wells. Undrilled locations are classified as having undeveloped reserves if a development plan has been adopted indicating that they are scheduled to be drilled within five years.

Probable and Possible reserves are not evaluated or provided in this report.

Reserves Estimates

The PDP production (reserves) forecast for each well is based on historical production data provided by Citadel and/or obtained from public records through the last production month available (December 2016) at the time of this report. The wells are evaluated using a decline curve analysis technique to determine the forecast of future oil production. The PDNP reserves are assigned to wells which Citadel proposes to RTP through a workover and/or re-entry of an existing shut-in or idle wellbore.

Historical well production data were analyzed for the Citadel leases to develop type curves of forecasted oil production for the RTP wells and for new infill wells. The PUD reserves are assigned to infill oil wells proposed to be drilled on the Needham-Bloemer, Titus and Wells-McGregor leases. There are no gas sales or gas reserves for any existing or planned wells at this time of this report.

The historical field production and future decline forecast for the PDP reserves are shown by **FIGURE 2**. **FIGURE 3** presents the stacked plot of the future production forecasts for the PDP, PDNP and PUD oil reserves. The individual production plots and forecasts by well are included in **APPENDIX B**.

Discounted Cash Flow Evaluation

Reserves in this report are determined as of December 31, 2016 to the defined economic limit based on a discounted cash flow analysis using the prices, interests, and operating cost inputs provided by Citadel. The economic summaries by reserves category are given in **TABLES 1** through **4**. One-line summaries of the individual reserves cases are presented in **TABLE 5**. The cash flow analyses of the individual cases are presented in **APPENDIX C**.

Hydrocarbon Prices

The crude oil price parameter for the SEC Case is defined by SEC as the unweighted arithmetic average of the first-of-the-month prices for the 12-month period prior to the “as of” date. For this report the 12-month period is January to December 2016.

MHA determined the SEC pricing based on the average West Texas Intermediate (WTI) posted price (WTI Spot Price) adjusted for quality, local market differentials, and transportation (**APPENDIX D**). The price adjustment relies on the sales price differentials between the WTI Spot Price and the Kern Bluff realized prices. The quality of the Kern Bluff crude oil is 15 degree API gravity.

Hydrocarbon Product	Price Benchmark	12-mo Average WTI Spot Price	Average Price Differential	Adjusted Price	Oil
Crude Oil	NYMEX WTI Cushing, OK Spot Price	\$42.75/bbl	-\$7.22/bbl	\$35.53/bbl	

Using this methodology, the crude oil price is \$35.53/barrel, which is held constant for the life of the SEC reserves.

Costs

Calendar Year 2016 lease operating expense (OPEX) data were provided by Citadel for its Kern Bluff field operations (**APPENDIX D**). MHA analyzed these costs and calculated fixed and variable cost projections based on the active wells for the Santa Margarita, Chanac and Transition zones. The PDP wells are being operated as cold primary production but Citadel’s Plan of Development includes the purchase and installation of a 15 MMBTU/hour steam generator to enable lease-wide cyclic steam stimulation (CSS) of existing and new wells. CSS improved recovery techniques have been proved effective in this field by previous operators.

Estimated operating costs under CSS are given in the table below.

CSS Operations Zone	Fixed Cost (\$/well-month)	Variable Cost (\$/bbl oil)	Steam Cost (\$/bbl steam inj)	Steam-Oil Ratio Range (bbl/bbl)
Transition (PUD)	3,150	0.00	2.50	2.0 - 2.5
Santa Margarita (RTP)	2,700	5.40	2.50	2.0 - 5.0
Santa Margarita (PUD)	2,700	5.40	2.50	1.0 - 5.0

The projected OPEX include only those costs directly applicable to the leases and wells. Headquarters general and administrative overhead expenses are not included. Per SEC guidelines, costs and expenses are un-escalated over the life of the reserves.

Adopted Development Plan

An adopted capital development plan (**APPENDIX E**) was provided by Citadel and it appeared reasonable for its Kern Bluff properties. Well recompletion, new well construction, and facility capital investments are estimated to be a total of \$8.785 million over a five year period. Capital costs for new wells are estimated based on typical California well construction costs to drill and complete an oil well to a total depth of approximately 1,500 feet. The development plan used in this reserves analysis is as follows:

PDNP (RTP wells):

- A total of 15 idle vertical wells on the Needham-Bloemer lease will be re-worked and returned to production beginning in Q2 2017 and concluded by Q1 2022.
- Cost per well for the planned work is 40.0 M\$.

PUD (Facilities)

- Cyclic steam stimulation activities will be re-activated for the Kern Bluff field with the purchase and installation of a 15 MMBTU/hour steam generator.

PUD (New wells):

- A total of 30 locations are identified as infill wells to be constructed during the next five years (see **FIGURE 4**). The new wells are located on undrilled acreage directly offsetting existing production on the Needham-Bloemer (20 wells), Wells-McGregor (9) and Titus (1) leases.
- Drilling, completion and facility costs per Citadel's prepared Authorization for Expenditure are estimated at 235 M\$ per well.

All capital investments are un-escalated. Equipment salvage values and future abandonment costs are not included in this analysis.

The net income values presented in the economic summary tables include a deduction for estimated local ad valorem and state assessment taxes as follows:

Assessment and Ad Valorem Taxation Rates Used in Economic Analyses		
State	Assessment	Ad Valorem
California - Oil	\$0.363/bbl	2.0%

Report Qualifications

4700 Stockdale Hwy., Suite 110, Bakersfield, CA 93309 ; Ph: 661-325-0038 Fax: 661-325-4178
 730 17TH Street, Suite 410, Denver, CO 80202; Ph: 303-277-0270 Fax: 303-277-0267, www.mhousa.com

The reserves and valuations indicated in this report are estimates only and should not be considered as exact quantities. They represent our best judgments, after having utilized generally accepted engineering, geologic, and economic procedures. Moreover, the net revenues indicated herein should not be construed as fair market values.

It is MHA's opinion that the estimated proved reserves and other reserve information as specified in this report are reasonable and have been prepared in accordance with generally accepted petroleum engineering and evaluation principles, as set forth in the SEC regulations. Notwithstanding the aforementioned opinion, MHA makes no warranties concerning the data and interpretations of such data. In no event shall MHA be liable for any special or consequential damages arising from Citadel's use of MHA's interpretation, reports, or services produced as a result of its work for Citadel.

All the information furnished by Citadel was accepted without any attempt at independent verification. MHA carried out such tests as we considered necessary to check the veracity of the oil production data, operating costs, and engineering procedures. In evaluating the information at our disposal, we excluded from our consideration all legal and accounting matters, which may be controlling.

Statement of Risk

The accuracy of reserves and economic evaluations is always subject to uncertainty. The magnitude of this uncertainty is generally proportional to the quantity and quality of data available for analysis. As a well matures and new information becomes available, revisions may be required which may either increase or decrease the previous reserve assignments. Sometimes these revisions may result not only in a significant change to the reserves and value assigned to a property, but also may impact the total company reserve and economic status.

The reserves and forecasts contained in this report were based upon a technical analysis of the available data using accepted engineering principles. However, they must be accepted with the understanding that further information and future reservoir performance subsequent to the date of the estimate may justify their revision.

Consent

We hereby consent to the references to our firm, in the context in which they appear, and to our reserve estimates as of December 31, 2016, included in the Annual Report on Form 10-K of Citadel Exploration Inc. for the fiscal year ended December 31, 2016, as well as in the notes to the consolidated financial statements included therein. We also hereby consent to the incorporation by reference of the references to our firm, in the context in which they appear, and to the reserve estimates as of December 31, 2016, in our report dated March 22, 2017 for the Citadel Annual Report on Form 10-K.

Thank you for the opportunity to prepare this report. All the basic petroleum engineering calculations and supporting data remain in MHA files for future reference by Citadel or its representatives. Please feel free to contact us with any questions or to request further information.

Very truly yours,

MHA PETROLEUM CONSULTANTS, LLC

Alan A. Burzlaff



Alan A. Burzlaff, P.E.
Managing Partner

Professional Petroleum Engineer

Licensed by the California Board for
Professional Engineers and Land Surveyors
License No. P1386

Date Signed: March 22, 2017

