

DAYBREAK OIL AND GAS, INC. Valuation-Changing Deal Accelerates Time to Profit

Rob Goldman
rob@goldmanresearch.com

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Aaron Schweitzer
aaron@goldmanresearch.com

DAYBREAK OIL AND GAS, INC. (OTC:QB – DBRM - \$0.19)	
Price Target: \$0.95	Rating: Speculative Buy

COMPANY SNAPSHOT

Daybreak Oil and Gas, Inc. is an independent oil and gas company engaged in the exploration, development and production of oil and gas in California and Kentucky. The Company is headquartered in Spokane, Washington with an operations office in Friendswood, Texas. Daybreak owns a 3-D seismic survey that encompasses 20,000 acres over 32 square miles with approximately 13,000 acres under lease in the San Joaquin Valley of California. Daybreak also owns a 25% working interest in approximately 6,100 acres under lease in the Appalachian Basin in Lawrence County, Kentucky.

KEY STATISTICS

Price as of 9/3/13	\$0.19
52 Wk High – Low	\$0.23– 0.01
Est. Shares Outstanding	48.9M
Market Capitalization	\$9.3M
3 Mo Avg Vol	39,000
Exchange	OTC:QB

COMPANY INFORMATION

Daybreak Oil and Gas, Inc.
601 W. Main Ave
Suite 1017
Spokane WA 99201
www.daybreakoilandgas.com
Ed Capko, Investor Relations
815-942-2581
edc@daybreakoilandgas.com

KEY TAKEAWAYS

Daybreak announced it has acquired a 25% working interest in 6,100 acres under lease in the Appalachian Basin in Lawrence County, KY which should initially produce more than double the current average barrel of oil production per well of its 18 California wells. This news comes just 60 days following remarkable production results from its recent drilling program at the East Slopes Project in Kern County, California which doubled the previous daily production of Daybreak's previously existing wells.

Oil reserves per well are expected to have an estimated ultimate recovery of 50,000 barrels of oil. The first well has already been spud and other shallow wells will be drilled in the coming months. In total, management has identified over 50 future drilling locations on the leases.

As part of the transaction, DBRM has amended its credit facility to reflect more favorable terms that will enable it to grow substantially larger and faster than we originally anticipated. The credit facility was raised from \$20M to \$50M and the interest rate declined by one-third to 12% from 18%.

Make no mistake: The Kentucky deal is a game-changing and valuation transaction for Daybreak as it accelerates revenue growth and time to profit well ahead of initial forecasts. As a result, DBRM has just scratched the surface of its production potential. We reiterate our Speculative Buy rating and based on the recent news, we will likely raise our \$0.95 price target following the completion and release of a financial model.



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Transaction Overview: Huge Revenue Growth and Profit Around the Corner

Daybreak just acquired a 25% working interest in approximately 6,100 acres in two large contiguous acreage blocks in the Twin Bottoms Field in Lawrence County, Kentucky. App Energy, LLC is the operator of the project and owns the remaining 75% working interest. This transaction fits the Daybreak model perfectly. The land has indicated shallow oil, is low risk, and offers a low drilling and completion cost. Pursuant to a joint operating agreement between App and Daybreak, the two companies have committed to drill three shallow horizontal oil wells in the Berea Oil Sand, which is at approximately 1,500 feet with over 50 drilling locations identified on the leases. Vertical gas wells currently on the leases have penetrated the Berea Oil Sand with log and other data indicating potential proved oil reserves are present in these reservoirs.

We should note that Daybreak is batting 1.000 on development wells---and we should see that streak continue.

In this same area of Lawrence County, 40+ horizontal oil wells have been drilled in the Berea Sand in the past year with substantial initial oil production rates along with associated natural gas. Oil reserves per well are expected to have an estimated ultimate recovery of 50,000 barrels of oil with estimated well cost of approximately \$800,000 per completed well depending on the length of the lateral production leg of the well.

It is expected that the Kentucky wells will have initial production rates that are substantially higher (more than double) the average production per well in the Company's California sites, with the levels declining and steadying to an equivalent daily production to the California wells within a year of being brought into production. Management plans to drill 3 wells in Kentucky before year-end and it is clear that the Company is primed to generate cash flow profitability as early as the current quarter, ended November.

It Doesn't Get Better Than This

It is important to note that the Company's financing source introduced Daybreak to App which bodes extremely well for the Company and its shareholders. Under normal circumstances, small, independent exploration and production firms tend to have issues sourcing capital for expansion. The fact that the financier, Maximilian Investors LLC, introduced the two parties, illustrates the confidence it has in Daybreak's model, management, and that it wants to be a part of Daybreak's future, given that the risk profile is clearly lowered.

These subtle factors were illustrated by Maximilian Investors' willingness to increase the Company's initial facility from \$20 million to \$50 million and substantially lower its interest rate from 18% to 12% per annum. The amended and restated credit facility also provides for Maximilian to loan funds to the Company under a separate \$40 million credit line to be loaned by the Company to App, primarily to fund its drilling operations. The funds initially loaned to App will accrue interest at 16.8% per annum and subsequent advances will accrue interest at 12% per annum. App's obligations to the Company are secured by a lien on and security interest in substantially all of App's property, including substantially all of its oil and gas interests in Kentucky.

As a result of Maximilian introducing the Kentucky transaction with App to the Company, Maximilian was issued 6.1 million shares of the Company's common stock on a fully-diluted basis and a warrant to purchase 6.1 million shares of the Company's common stock on a fully-diluted basis at \$.10 per share. The Company has also granted to Maximilian a net profits interest of 50% of its net profits after the Company has recovered

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its costs from its Kentucky drilling operations with App. Maximilian is wedded to Daybreak not just as a lender but as a shareholder, as its ownership stake is nearly 20%, including the warrants.

Conclusion

The Kentucky deal is a is a game-changing and valuation transaction for Daybreak as it accelerates prospective operational and financial achievement well beyond our initial assessment.

With the closing of this fortuitous transaction, Daybreak is primed to earn meaningful operating profit in addition to a much higher profile in the industry and on Wall Street. Plus, in California, 5 additional wells will be drilled to add to the 18 currently producing wells. In Kentucky, 3 wells will be drilled in the coming months, with nearly 50 more locations targeted for future drilling. As investors realize what a tremendous value DBRM offers, it should easily break through the \$0.23 level achieved 2 months ago, on its way to the \$0.30 mark in the near term. It may be further bolstered by the migration of investments toward domestic oil producers due to the perceivd geo-political risk in the Middle East.

We reiterate our Speculative Buy rating and based on the recent news, we will likely raise our \$0.95 price target following the completion and release of a financial model.

Recent Trading History For DBRM

(Source: Stockta.com)





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Senior Analyst: Robert Goldman

Rob Goldman founded Goldman Small Cap Research in 2009 and has over 20 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell side analyst, Rob was a senior member of Piper Jaffrey's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*.

Analyst Certification

I, Robert Goldman, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report.

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