DAYBREAK OIL & GAS, INC.

Under The Radar Firm To Double Revenue This Year

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DAYBREAK OIL & GAS, INC. (OTC:QB – DBRM - $0.16)	
Price Target: $0.95	Rating: Speculative Buy

COMPANY SNAPSHOT

Daybreak Oil & Gas, Inc. is an independent oil exploration and production company. The Company and its partners control oil producing property in fertile Kern County, California. The property is in the same region as the Occidental Petroleum discovery considered the largest California oil discovery in decades, potentially yielding hundreds of millions of barrels of oil. The Company drills cost-effective, shallow wells that are currently producing oil in 18 wells with plans to develop 20 more over the next few years in this potentially lucrative territory. Daybreak has nearly 300,000 proved oil reserves and on a net working interest basis, 3.8 million gross potential recoverable oil reserves.

KEY STATISTICS

Price as of 7/15/13	$0.16
52 Wk High – Low	$0.193– 0.01
Est. Shares Outstanding	48.9M
Market Capitalization	$7.8M
3 Mo Avg Vol	26,000
Exchange	OTC:QB

COMPANY INFORMATION

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INVESTMENT HIGHLIGHTS

Daybreak, along with partners, owns a 3-D seismic survey encompassing 20,000 acres over 32 square miles with approximately 13,000 acres under lease in the San Joaquin Valley. The property is in the same region as the Occidental Petroleum (NYSE – OXY) discovery which is considered the largest CA oil discovery in decades, potentially yielding hundreds of millions of barrels of oil.

Daybreak has nearly 300,000 barrels of proved oil reserves and on a net working interest basis, 3.8 million gross potential recoverable oil reserves. The Company has 18 oil producing wells with 5 more development wells coming online in the fall.

Based on the recent success of its development wells, the Company is expected to nearly double revenue from FY14 (Feb '13) to FY 15 (Feb '14) and generate meaningful profitability for the first time.

Daybreak arguably has some of the most enviable financial metrics in the entire industry. DBRM has hit on 100% of its development wells, may have the lowest operating costs at $18/per barrel, and is paid a premium on the prevailing West Texas Crude prices.

DBRM management may be one of the most conservative and shareholder friendly operators that we have ever come across.

With its infrastructure already in place, and new wells coming online to drive revenue growth and profitability, DBRM may be the most undervalued oil and gas play in the market. The stock trades at a huge discount to its peer group and at least a 50% discount to its PV10 value which measures the present value of future cash flows. We rate these shares Speculative Buy with a $0.95 price target.

COMPANY OVERVIEW

Headquartered in Spokane, Washington with an operations office in Friendswood, Texas, Daybreak Oil & Gas, Inc. is an independent oil exploration and production company. The Company and its partners control oil producing property in fertile Kern County, California, with Daybreak typically owning roughly 37.5% working interests in most of the leases. The property is in the same region as the Occidental Petroleum (NYSE – OXY) discovery which is considered by many as the largest California oil discovery in decades, potentially yielding hundreds of millions of barrels of oil. Daybreak, along with partners, owns a 3-D seismic survey that encompasses 20,000 acres with approximately 13,000 acres under lease in the San Joaquin Valley.

The Company's model is to drill cost-effective, shallow wells of 2,000-3,000 feet versus deep wells of 10,000 feet. This reduces risk and can be completed faster and at a lower upfront capital and operating cost. Since 2009, Daybreak has participated in the drilling of 22 wells with 18 of them producing oil as of June 2013, including seven new development wells. Over the past few years, management has ensured that the Company has the proper infrastructure for power and production large enough to accommodate more oil production than the current 20,000 annual BOE (barrels of oil) run-rate.

East Slopes Project Background

Daybreak's East Slopes Project is located in the southeastern part of the San Joaquin Basin near Bakersfield, California. During the three months ended May 31, 2013 Daybreak enjoyed production from 14 wells including start-up production from three wells that were newly drilled and put on production in late May 2013. In June 2013, the Company placed four additional wells on production. Initially, Daybreak intended to only drill 6 wells. Drilling targets are porous and permeable sandstone reservoirs which exist at depths of 1,200 feet to 4,500 feet.

At present, the Company has production from five reservoirs, referenced as its Sunday, Bear, Black, Ball and Dyer Creek locations. The current production breakdown is as follow:

Sunday:	*6 wells*
Bear:	*7 wells*
Black:	*2 wells*
Ball:	*2 wells*
Dyer Creek:	*1 well*

As noted above, since a number of prospects on trend with the Bear, Black and Dyer Creek reservoirs exhibiting similar same seismic characteristics, these prospects, if successful, would utilize the Company's existing production facilities. In addition to the current field development, management plans to drill 5 exploratory wells in the fall on the Bear and Ball properties and others are being contemplated for 2014 and beyond. Beginning in 2Q14, Daybreak will likely demonstrate a doubling of revenue and could approach operating cash flow profitability. Going forward, Daybreak plans to spend approximately $700,000 in new capital investments within the East Slopes Project area during the remainder of the current fiscal year ending February 2014.

DAYBREAK PROPERTIES

Going forward, the key properties for the Company's new production appear to Ball and Bear, with exploratory wells to be drilled on the huge Bull Run, Sherman, and Glide-Kendall properties. Each exploratory well costs roughly $300,000 to engage but given the risk reward and the Company's impeccable track record, 2014 could be an even more bountiful year for new wells than 2013.

Table I. Producing Property Overview

Daybreak Oil and Gas, Inc.
Producing Property Overview
Jul-13

Name	1st Well	New	Total	Acreage	Work Int	Net Rev Int	Future Wells
Sunday	2009	2	6	35	37.5%	30.1%	
Bear	2009	3	7	62	37.5%	30.1%	3
Black	2010	1	2	13	37.5%	29.8%	
Ball	2010	1	2	38	37.5%	31.2%	2
Dyer Creek	2010	1	1	10	37.5%	31.2%	1

*Interests reflect maximum per well.

Table II. Exploration Property Overview

Daybreak Oil and Gas, Inc.
Exploration Property Overview
Jul-13

Name	Acreage	Gross Recov. Reserves	Work Int	2013/2014 Exp. Wells
Bull Run	70	873,000 BOE	37.5%	1
Glide-Kendall	200	1,800,000 BOE	37.5%	1
Sherman	100	300,000 BOE	37.5%	1
Tobias	60	700,000 BOE	37.5%	0
Total	**430**	**3,673,000 BOE**	**37.5%**	**3**

The Company has 2 processing and storage facilities which are used by Daybreak's properties and are referred to as the Sunday, Bear, Black , Dyer Creek, and The Sunday Central Processing and Storage Facilitiy. The oil produced from the Company's acreage is considered heavy oil and ranges from 14° to 16° API gravity. All of the oil from the Sunday, Bear and Black properties is processed, stored and sold from the Sunday Central Processing and Storage Facility and must be heated to separate and remove water to prepare it to be sold. The Dyer Creek facility serves the Ball and Dyer Creek wells. By utilizing the Sunday and Dyer Creek centralized production facilities Daybreak's average operating costs have been reduced from over $40 per barrel to a monthly average of approximately $13 per barrel of oil for the three months ended May 31, 2013. With these centralized facilities and having permanent electrical power available, management ensures that its operating expenses are kept to a minimum.

Image I. Sunday Processing Facility
Source: Daybreak Oil and Gas, Inc.

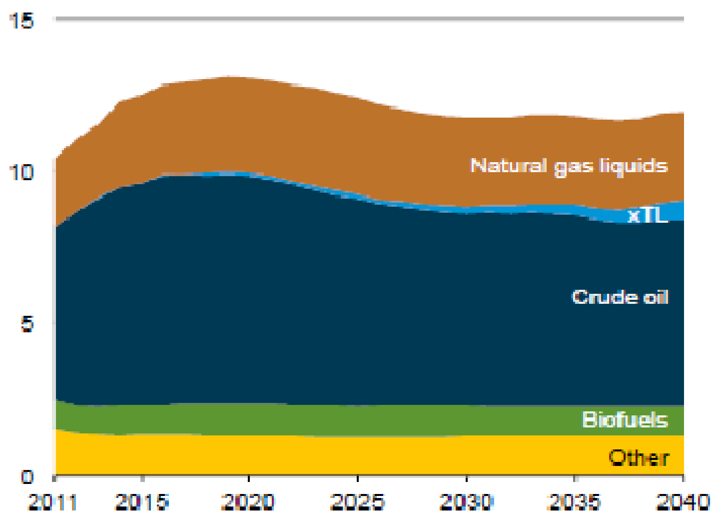
Image II. Drilling and Completion Rig at Bear site
Source: Daybreak Oil and Gas, Inc.

INDUSTRY OVERVIEW

Despite rising costs, there is still a high demand worldwide for oil which does not seem to be slowing down anytime soon. On the domestic front, we should note that the U.S. is migrating toward a goal of energy independence which would rely on oil produced on U.S. soil or offshore. Recent unrest in the Middle East has driven the price of oil meaningfully higher and any positive economic news is likely to aid oil's upward trajectory. All of these factors bode well for oil, going forward.

Figure 1 below highlights a forecast for petroleum and other liquids as a fuel source in the United States from the 2013 Annual Energy Outlook from the U.S. Energy Information Agency.

Figure 1: U.S. Production of Petroleum and Other Liquids by Source (Millions of Barrels Per Day)
(Source: EIA: 2013 Annual Energy Outlook)



COMPETITIVE ADVANTAGES

Daybreak has a number of advantages over similarly sized and even larger junior, domestic oil and gas exploration and production firms.

- Revenue producing Firm with 18 producing wells that should double revenue next year and enable operating profitability
- Large acreage and high working interests in historically successful region
- Shallow drilling strategy
- Infrastructure already in place
- Extremely low operating costs of $13/per barrel of oil
- Due to heavy oil concentration, DBRM recieves premium to West Texas Intermediate crude on it sales
- 100% success rate on developmental wells to date
- As more wells come on line, revenue will grow subtantially and profits go down to operating line
- Huge gross recoverable reserves of 3.8 MBOE (millions of barrels of oil)
- Nearly 300,000 barrels of proved oil reserves
- The stock trades at a 50% discount to its PV10 value which measures the present value of future cash flows
- Management is extremely conservative and shareholder friendly

THE DAYBREAK EXECUTIVE TEAM

James F. Westmoreland, President and Chief Executive Officer

James F. Westmoreland was appointed President and Chief Executive Officer and director in October 2008. He also serves as interim principal finance and accounting officer. Prior to that, he had been our Executive Vice President and Chief Financial Officer since April 2008. He also served as the Company's interim Chief Financial Officer from December 2007 to April 2008. From August 2007 to December 2007, he consulted with the Company on various accounting and finance matters. Prior to that time, Mr. Westmoreland was employed in various financial and accounting capacities for The Houston Exploration Company for 21 years, including Vice President, Controller and Corporate Secretary, serving as its Vice President and Chief Accounting Officer from October 1995 until its acquisition by Forest Oil Corporation in June 2007. Mr. Westmoreland has over 30 years of experience in oil and gas accounting, finance, corporate compliance and governance, both in the public and private sector. He earned his Bachelor of Business Administration in accounting from the University of Houston.

Bennett W. Anderson, Chief Operating Officer

Bennett W. Anderson was appointed Chief Operating Officer in 2006. Prior to that time, he was a private investor from 2002 - 2006. He served as a Senior Vice President with Novell, Inc. from 1998-2002. Mr. Anderson's duties included product direction, strategy and market direction, and training and support for the field sales staff. From 1978 to 1982, Mr. Anderson worked as a rig hand and was involved in drilling over a dozen wells in North Dakota. He holds a Bachelor of Science from Brigham Young University in Computer Science and graduated with University Honors of Distinction.

RISK FACTORS

In our view, the biggest risks to Daybreak's success would be dry wells. However, given the Company's unusual ability to successfully drill developmental wells, we do not deem this as a material risk. In the past, the largest risk relative to the Company's fortunes was the access to capital. But, with its recent successes in short order, we do not believe that is the case any longer. Moreover, these properties could become attractive to larger players as additional wells are drilled and become producing. Investors should be aware that the 1st Quarter 10-Q just released by the Company does not reflect the recently announced new wells and therefore may be misleading to investors. Beginning with the next quarter, Daybreak will record revenue that is double that of the prior year and could approach operating cash flow profitability.

VALUATION AND CONCLUSION

With key drilling and financial milestones ahead, this underfollowed stock should rise dramatically from its current sleepy level. Moreover, with its infrastructure already in place, low operating costs, and new wells from its large acreage coming online to drive revenue growth and profitability, DBRM may be the most undervalued oil and gas play in the market. Following the recording $975,000 in revenue for fiscal 2013, we believe that revenue could nearly double in fiscal 2014 and expect that DBRM will record annual operating cash profitability. If management continues on this torrid success rate of new wells, it is possible that revenue could double again in FY15, with $1M in operating profit.

As noted earlier, the Company receives a sales premium to the West Texas Intermediate prevailing price of oil, has huge prospects and low operating costs. Thus, Daybreak should trade at a premium to its peer group, rather than a discount. As indicated in the table below, comparable oil companies trade anywhere from 7-100x trailing twelve months revenue. Based on the valuation noted in the table, we believe that the stock will reach the $0.45 mark in the next 6 months and $0.95 in a year's time.

For example, Royale Energy is a natural gas company operating in Daybreak's backyard. Although it is primarily in natural gas rather than oil, we believe it is a great comp for the company as it trades at a modest 8.6x trailing twelve months revenue. Since DBRM's fiscal year ends in February 2014, we believe that it can trade at a 12x price/sales multiple on FY14 revenue, which equates to a $0.45 price objective. Moreover, this valuation is still a major discount to the peer group. Going forward, if management is able to double revenue again, and we use the same P/S multiple, DBRM will reach our longer term $0.95 price target.

We should note that the present value of future net cash flows from proved reserves, before deductions for estimated future income taxes and asset retirement obligations, discounted at 10% ("PV-10"), totaled $13.3 million at February 28, 2013, which is twice the current market cap. The commodity prices used to estimate proved reserves and their related PV-10 at February 28, 2013 were based on the 12-month unweight arithmetic average of the first-day-of-the-month price for the period from March 2012 through February 2013. The benchmark average for the year ended February 28, 2013 was $97.56 per barrel of oil. This figure will likely be adjusted higher next year which will also have a positive impact on the stock.

We rate these shares Speculative Buy.

Table III. DBRM Comparable Analysis

Daybreak Oil and Gas, Inc.
Peer Group Analysis
Jul-13

Name	Symbol	Price	Mkt Cap (M)	TTM Rev (M)	P/S Ratio
Camac Energy	CAK	$0.60	$94	$13.4	7.0
Mag. Petro	MPET	$1.07	$48	$7.30	6.6
Royale Energy	ROYL	$2.75	$36	$4.20	8.6
Riverdale	RVDO	$0.05	$1	$0.04	32.5
Bering Expl	BERX	$0.13	$2	$0.10	20.0
Eagleford	EFRDF	$0.04	$4	$0.04	100.0
Average			$31	$4.18	29.1
Daybreak*	**DBRM**	**$0.14**	**$6.6**	**$1.8**	**3.7**
Daybreak**	**DBRM**	**$0.95**	**$45.0**	**$3.6**	**12.5**

*denotes TTM as of FY14 sales

**denotes TTM as of FY15 sales

Recent Trading History For DBRM

(Source: Stockta.com)

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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