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

FORM 10-Q

(Mark One)

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

For the quarterly period ended August 31, 2022

OR

☐ 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: 000-50107

DAYBREAK OIL AND GAS, INC.

(Exact name of registrant as specified in its charter)

Washington	**91-0626366**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1414 S. Friendswood Dr., Suite 212, Friendswood, TX	**77546**
(Address of principal executive offices)	(Zip code)

(509) 232-7674
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
n/a	n/a	n/a

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 every Interactive Data File required to be submitted 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

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

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

At October 25, 2022 the registrant had 384,735,402 outstanding shares of $0.001 par value common stock.

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DAYBREAK OIL AND GAS, INC.
Balance Sheets – Unaudited

		As of August 31, 2022		As of February 28, 2022
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	$	412,949	$	139,573
Restricted cash		275,000		—
Accounts receivable:				
Crude oil sales		223,639		117,727
Joint interest participants		305,774		85,339
Prepaid expenses and other current assets		23,068		74,012
Total current assets		1,240,430		416,651
LONG-TERM ASSETS:				
Crude oil properties, successful efforts method, net				
Proved properties		5,423,957		536,032
Unproved properties		—		—
Prepaid drilling costs		16,452		16,452
Property, plant and equipment, net		4,992		6,569
Goodwill, crude oil and natural gas properties		1,876,264		—
Total long-term assets		7,321,665		559,053
Total assets	$	8,562,095	$	975,704
LIABILITIES AND STOCKHOLDERS' DEFICIT				
CURRENT LIABILITIES:				
Accounts payable and other accrued liabilities	$	2,005,762	$	1,649,119
Accounts payable – related parties		23,307		49,228
Accrued interest		162,251		176,229
Note payable		120,000		120,000
Note payable – related party, current, net of unamortized discount of $729 and $729, respectively		8,218		8,100
Convertible Notes payable – related party		—		200,000
12% Notes payable		290,000		315,000
Production revenue payable - current, net of unamortized discount		251,734		78,877
Line of credit		—		808,182
Total current liabilities		2,861,272		3,404,735
LONG-TERM LIABILITIES:				
Note payable – related party, net of current portion and net of unamortized discount of $8,985 and $9,350, respectively		123,222		127,360
Production revenue payable, net of unamortized discount and current portion		633,873		738,248
Asset retirement obligation		215,707		52,565
Total long-term liabilities		972,802		918,173
Total liabilities		3,834,074		4,322,908
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS' EQUITY (DEFICIT):				
Common stock – 500,000,000 shares authorized; $0.001 par value, 384,735,402 and 67,802,273 shares issued and outstanding, respectively		384,735		67,802
Additional paid-in capital		35,297,706		26,115,450
Accumulated deficit		(30,954,420)		(29,530,456)
Total stockholders' equity and (deficit)		4,728,021		(3,347,204)
Total liabilities and stockholders' equity and (deficit)	$	8,562,095	$	975,704

The accompanying notes are an integral part of these unaudited financial statements

DAYBREAK OIL AND GAS, INC.
Statements of Operations – Unaudited

	For the Three Months Ended August 31,		For the Six Months Ended August 31,	
	2022	2021	2022	2021
REVENUE:				
Crude oil sales	$ 531,283	$ 169,318	$ 778,898	$ 316,618
Natural gas sales	9,748	—	9,748	—
Total crude oil and natural gas sales	541,031	169,318	788,646	316,618
OPERATING EXPENSES:				
Production	298,482	52,843	359,199	99,569
Exploration and drilling (G&G)	1,170	201	1,170	201
Depreciation, depletion, and amortization (DD&A)	137,888	14,860	149,664	28,808
Transaction (acquisition) expenses	—	—	1,025,541	—
General and administrative	286,322	119,163	538,460	286,788
Total operating expenses	723,862	187,067	2,074,034	415,366
OPERATING LOSS	(182,831)	(17,749)	(1,285,388)	(98,748)
OTHER INCOME (EXPENSE):				
Gain on asset disposal	—	—	—	9,614
Interest expense, net	(67,646)	(54,331)	(138,576)	(115,597)
NET LOSS	(250,477)	(72,080)	(1,423,964)	(204,731)
Cumulative convertible preferred stock dividend requirement	—	(32,191)	—	(64,382)
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	$ (250,477)	$ (104,271)	$ (1,423,964)	$ (269,113)
NET LOSS PER COMMON SHARE, basic and diluted	$ (0.001)	$ (0.002)	$ (0.006)	$ (0.004)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - Basic and diluted	384,618,402	60,491,122	239,424,109	60,491,122

The accompanying notes are an integral part of these unaudited financial statements

DAYBREAK OIL AND GAS, INC.
Consolidated Statements of Changes in Stockholders' Deficit
For the Three and Six Months Ended August 31, 2022 August 2021

	Series A Convertible Preferred Stock		Common Stock		Additional Paid-In	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Deficit	Total
BALANCE, FEBRUARY 28, 2022	—	$ —	67,802,273	$ 67,802	$ 26,115,450	$ (29,530,456)	$ (3,347,204)
Issuance of common stock for:							
Conversion of 12% Note principal and interest	—	—	78,934	79	35,441	—	35,520
Conversion of Convertible Note	—	—	27,764,706	27,765	208,235	—	236,000
Acquisition of oil and gas property	—	—	160,964,489	160,964	6,438,580	—	6,559,544
Sale of common stock	—	—	128,125,000	128,125	2,500,000	—	2,628,125
Net loss	—	—	—	—	—	(1,173,487)	(1,173,487)
BALANCE, MAY 31, 2022	—	$ —	384,735,402	$ 384,735	$ 35,297,706	$ (30,703,943)	$ 4,978,498
Net loss	—	—	—	—	—	(250,477)	(250,477)
BALANCE, AUGUST 31, 2022	—	$ —	384,735,402	$ 384,735	$ 35,297,706	$ (30,954,420)	$ 4,728,021

	Series A Convertible Preferred Stock		Common Stock		Additional Paid-In	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Deficit	Total
BALANCE, FEBRUARY 28, 2021	709,568	$ 710	60,491,122	$ 60,491	$ 24,250,556	$ (29,428,897)	$ (5,117,140)
Recognition of warrants issued for:							
Investor relations services	—	—	—	—	1,474	—	1,474
Net loss	—	—	—	—	—	(132,651)	(132,651)
BALANCE, MAY 31, 2021	709,568	$ 710	60,491,122	$ 60,491	$ 24,252,030	$ (29,561,548)	$ (5,248,317)
Recognition of warrants issued for:							
Investor relations services	—	—	—	—	1,474	—	1,474
Net loss	—	—	—	—	—	(72,080)	(72,080)
BALANCE, AUGUST 31, 2021	709,568	$ 710	60,491,122	$ 60,491	$ 24,253,504	$ (29,633,628)	$ (5,318,923)

The accompanying notes are an integral part of these unaudited financial statements

DAYBREAK OIL AND GAS, INC.
Statements of Cash Flows – Unaudited

	Six Months Ended	
	August 31, 2022	August 31, 2021
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (1,423,964)	$ (204,731)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation, depletion, amortization and impairment expense	149,664	28,808
Amortization of debt discount	68,846	54,668
Financing fee expense	512,500	—
Warrant issued for investor relations services	—	2,948
Changes in assets and liabilities:		
Accounts receivable – crude oil sales	(105,912)	15,644
Accounts receivable – joint interest participants	(220,435)	39,459
Prepaid expenses and other current assets	50,944	39,276
Accounts payable and other accrued liabilities	416,073	(24,292)
Accounts payable – related parties	(25,921)	50,543
Accrued interest	(13,978)	39,006
Net cash provided by (used in) operating activities	(592,183)	41,329
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to crude oil properties	—	(3,647)
Purchase of fixed assets	—	(9,460)
Net cash used in investing activities	—	(13,107)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from paycheck protection program (PPP) loan	—	72,800
Payments to line of credit	(808,182)	(30,000)
Proceeds from sale of common stock	1,987,500	—
Insurance financing repayments	(34,375)	(43,140)
Payments on note payable – related party	(4,384)	(4,271)
Net cash (used in) provided by financing activities	1,140,559	(4,611)
NET INCREASE (DECREASE) IN CASH AND RESTRICTED CASH	548,376	23,611
CASH AND RESTRICTED CASH AT BEGINNING OF PERIOD	139,573	33,528
CASH AND RESTRICTED CASH AT END OF PERIOD	$ 687,949	$ 57,139
CASH PAID FOR:		
Interest	$ 15,227	$ 6,887
Income taxes	$ —	$ —
SUPPLEMENTAL CASH FLOW INFORMATION:		
Non-cash increase to line of credit due to monthly interest	$ —	$ 13,951
Common stock issued for conversion of 12% Subordinated Note	$ 35,520	$ —
Common stock issued for conversion of convertible Note	$ 236,000	$ —
Common stock issued for acquisition of crude oil and natural gas property	$ 6,599,544	$ —
Common stock issued for financing fees	$ 128,125	$ —
Goodwill from acquisition of O&G properties	$ 1,876,264	$ —
ARO asset and liability increase due to acquisition of O&G properties	$ 154,133	$ —

The accompanying notes are an integral part of these unaudited financial statements

NOTE 1 — ORGANIZATION AND BASIS OF PRESENTATION:

Organization

Originally incorporated as Daybreak Uranium, Inc., (“Daybreak Uranium”) on March 11, 1955, under the laws of the State of Washington, Daybreak Uranium was organized to explore for, acquire, and develop mineral properties in the Western United States. In August 1955, the assets of Morning Sun Uranium, Inc. were acquired by Daybreak Uranium. In May 1964, Daybreak Uranium changed its name to Daybreak Mines, Inc. During 2005, management of the Company decided to enter the crude oil and natural gas exploration, development and production industry. On October 25, 2005, the Company shareholders approved a name change from Daybreak Mines, Inc. to Daybreak Oil and Gas, Inc. (referred to herein as “Daybreak” or the “Company”) to better reflect the business of the Company.

All of the Company’s crude oil production is sold under contracts which are market-sensitive. Accordingly, the Company’s financial condition, results of operations, and capital resources are highly dependent upon prevailing market prices of, and demand for, crude oil. These commodity prices are subject to wide fluctuations and market uncertainties due to a variety of factors that are beyond the control of the Company. These factors may include the level of global demand for petroleum (hydrocarbon) products; foreign supply of crude oil and natural gas; the establishment of and compliance with production quotas by crude oil-exporting countries; the relative strength of the U.S. dollar; weather conditions; the price and availability of alternative fuels; overall economic conditions, both foreign and domestic; crude oil price disputes between OPEC and non-OPEC members; and national and international pandemics like the coronavirus outbreak.

Basis of Presentation

The accompanying unaudited interim financial statements and notes for the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q for quarterly reports under Section 13 or 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”). Accordingly, they do not include all of the information and footnote disclosures normally required by accounting principles generally accepted in the United States of America for complete financial statements.

In the opinion of management, all adjustments considered necessary for a fair presentation of the financial statements have been included and such adjustments are of a normal recurring nature. Operating results for the six months ended August 31, 2022 are not necessarily indicative of the results that may be expected for the fiscal year ending February 28, 2023.

These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended February 28, 2022.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions. These estimates and assumptions may affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the reporting period. Actual results could differ materially from those estimates. The accounting policies most affected by management’s estimates and assumptions are as follows:

- The reliance on estimates of proved reserves to compute the provision for depreciation, depletion and amortization (“DD&A”) and to determine the amount of any impairment of proved properties;
- The valuation of unproved acreage and proved crude oil properties to determine the amount of any impairment of crude oil properties;
- Judgment regarding the productive status of in-progress exploratory wells to determine the amount of any provision for abandonment; and
- Estimates regarding abandonment obligations; and
- Estimates regarding projected cash flows used in determining the production payable discount.

Earnings per Share

The Company follows ASC Topic 260, *Earnings per Share*, to account for the earnings per share. Basic earnings per common share ("EPS") calculations are determined by dividing net income (loss) 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 (loss) 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.

NOTE 2 — GOING CONCERN:

Financial Condition

The Company's financial statements for the six months ended August 31, 2022 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. The Company has incurred net operating losses since entering the crude oil exploration industry and as of August 31, 2022 has an accumulated deficit of $30.95 million and a working capital deficit of $1.6 million which raises substantial doubt about the Company's ability to continue as a going concern.

Management Plans to Continue as a Going Concern

The Company continues to implement plans to enhance its ability to continue as a going concern. Daybreak currently has a net revenue interest ("NRI") in 20 producing crude oil wells in its East Slopes Project located in Kern County, California (the "East Slopes Project"). The revenue from these wells has created a steady and reliable source of income for the Company. The Company's average working interest ("WI") in these wells is 36.6% and the average net revenue interest ("NRI") is 27.6% for these same wells.
In May 2022, the Company acquired Reabold California, LLC ("Reabold") from a third party. This property currently includes four producing wells, five shut-in wells and two potential disposal wells in the Monterey and Contra Costa counties of California. We have a 50% working interest with a 40% net revenue interest in this project.

In conjunction with our acquisition of Reabold, the Company was able to secure a capital raise of $2,500,000 through the issuances of the Company's common stock.

The Company anticipates its revenue will continue to increase as the Company participates in the drilling of more wells in the East Slopes and the Reabold Projects in California. Daybreak's sources of funds in the past have included the debt or equity markets and the sale of assets. It will be necessary for the Company to obtain additional funding from the private or public debt or equity markets in the future. However, the Company cannot offer any assurance that it will be successful in executing the aforementioned plans to continue as a going concern.

Daybreak's financial statements as of August 31, 2022 do not include any adjustments that might result from the inability to implement or execute the Company's plans to improve its ability to continue as a going concern.

NOTE 3 — CONCENTRATION RISK:

Substantially all of the Company's trade accounts receivable consists of receivables from two sources: (1) the sale of crude oil and natural gas production from operations by the Company and (2) from receivables from the Company's working interest partners in the East Slopes project where we are the Operator or from the Reabold project where we have one working interest partner. This concentration of customers and joint interest owners may impact the Company's overall credit risk, as these entities could be affected by similar changes in economic conditions including lower crude oil prices as well as other related factors. Trade accounts receivable are generally not collateralized.

At the Company's East Slopes and Reabold projects in California, there is only one buyer for the purchase of crude oil production and one buyer for our natural gas production in the Reabold project. The Company has no natural gas production in the East Slopes project. At August 31, 2022 and February 28, 2022 these customers represented 100.0% of crude oil and natural gas sales receivable. If these buyers are unable to resell their products or if they lose a significant sales contract, the Company may incur difficulties in selling its crude oil and natural gas production.

Crude oil and natural gas sales receivables balances of $223,639 and $117,727 at August 31, 2022 and February 28, 2022, represent crude oil and natural gas sales that occurred in August and February 2022, respectively.

Joint interest participant receivables balances of $305,774 and $85,339 at August 31, 2022 and February 28, 2022, respectively, represent amounts due from our working interest partners in both the East Slopes and Reabold projects. There were no allowances for doubtful accounts for the Company's trade accounts receivable at August 31, 2022 and February 28, 2022, as the joint interest owners have a history of paying their obligations.

NOTE 4 — CRUDE OIL PROPERTIES:

Crude oil property balances at August 31, 2022 and February 28, 2022 are set forth in the table below.

	August 31, 2022	February 28, 2022
Proved leasehold costs	$ 115,119	$ 115,119
Costs of wells and development	7,327,473	2,309,628
Capitalized exploratory well costs	1,341,494	1,341,494
Cost of proved crude oil properties	8,784,086	3,766,241
Accumulated depletion, depreciation, amortization and impairment	(3,360,129)	(3,230,209)
Proved crude oil properties, net	$ 5,423,957	$ 536,032
Unproved crude oil properties	—	—
Total proved and unproved crude oil properties, net	$ 5,423,957	$ 536,032

On May 25, 2022, the Company finalized the acquisition of Reabold California, LLC ("Reabold"). This property includes producing wells in both the Monterey and Contra Costa counties of California. This project includes four producing wells, five shut-in wells and the potential for two disposal wells. The Company has a 50% working interest with a 40% net revenue interest in this project. The balances above include the Reabold acquisition.

NOTE 5 – ACQUISITION

On May 25, 2022, the Company finalized the acquisition of Reabold from a third party for 160,964,489 shares of the Company's common stock valued at $6,599,544. The transaction balance of $6,863,163 reflects the common stock valuation of the acquisition transaction and $263,619 in reimbursements to the seller as a purchase price adjustment relating to expenditures for workovers agreed to by the Company and the third party. The following table presents the estimated allocation of the purchase price of the assets acquired and liabilities assumed for the acquisition.

Crude oil and natural gas property and equipment	$ 4,694,563
Goodwill	1,876,264
Accounts payable	(263,619)
Other liabilities	(292,336)
Purchase price, net of closing adjustments	$ 6,599,544

This preliminary allocation is based on management's estimated fair value of the Reabold assets and liabilities at May 25, 2022, and is subject to adjustment when a third party valuation to determine the fair value of the assets for ASC 805, Business Combinations reporting purposes is received. Adjustments made to the Reabold assets are derived from a total value of $6,599,544, based on 160,964,489 shares of stock issued for the acquisition and the closing price that day of $0.041 per share. From that amount, total assets acquired of $4,694,563 was deducted, and total liabilities acquired of $555,955 were added back to arrive at the $1,876,264 of Goodwill recorded. The Company incurred approximately $95,120 in transaction costs related to the Acquisition.

NOTE 6 — ACCOUNTS PAYABLE:

On March 1, 2009, the Company became the operator for its East Slopes Project located in Kern County, California. Additionally, the Company then assumed certain original defaulting partners' approximate $1.5 million liability representing a 25% working interest in the drilling and completion costs associated with the East Slopes Project four earning well program. The Company subsequently sold the same 25% working interest on June 11, 2009. Of the $1.5 million liability, $244,849 remains unpaid and is included in both the August 31, 2022 and February 28, 2022 accounts payable balances. Payment of this liability has been delayed until the Company's cash flow situation improves. On October 17, 2018, a working interest partner in California filed a UCC financing statement in regards to payables owed to the partner by the Company. At August 31, 2022 and February 28, 2022, the balance owed this working interest partner was $67,799 and $76,268, respectively, and is included in the approximate $2.0 million and $1.65 million accounts payable balance at August 31, 2022 and February 28, 2022, respectively.

NOTE 7 — ACCOUNTS PAYABLE- RELATED PARTIES:

The August 31, 2022 and February 28, 2022 accounts payable – related party balances of approximately $23,307 and $49,228 respectively, were comprised primarily of expense reimbursements to employees.

In California at the East Slopes Project, two of the vendors that the Company uses for services are partially owned by a related party, the Company's Chief Operating Officer. The Company's Chief Operating Officer is 50% owner in both Great Earth Power and ABPlus Net Holdings. Great Earth Power began providing a portion of the solar power electrical service for production operations in July 2020. ABPlus Net Holdings began providing portable tank rentals to the Company as a part of its water treatment and disposal operations in September 2020. The services provided by Great Earth Power and ABPlus Net Holdings are competitive with other vendors and save the Company significant expense. For the six months ended August 31, 2022 and 2021, Great Earth Power was paid $9,716 and $10,675, respectively. For the six months ended August 31, 2022 and 2021, ABPlus Net holdings was paid $5,760 and $5,760, respectively.

NOTE 8 — SHORT-TERM AND LONG-TERM BORROWINGS:

Note Payable

In December 2018, the Company was able to settle an outstanding balance owed to one of its third-party vendors. This settlement resulted in a $120,000 note payable being issued to the vendor. Additionally, the Company agreed to issue 2,000,000 shares of the Company's common stock as a part of the settlement agreement. Based on the closing price of the Company's common stock on the date of the settlement agreement, the value of the common stock transaction was determined to be $6,000. The common stock shares were issued during the twelve months ended February 29, 2020. The note has a maturity date of January 1, 2022 and bears an interest rate of 10% rate per annum. Monthly interest is accrued and payable on January 1st of each anniversary date until maturity of the note. At August 31, 2022, the accrued interest had not been paid and was outstanding. The accrued interest on the Note was $44,000 and $38,000 at August 31, 2022 and February 28, 2022, respectively.

Note Payable – Related Party

On December 22, 2020, the Company entered into a Secured Promissory Note (the "*Note*"), as borrower, with James Forrest Westmoreland and Angela Marie Westmoreland, Co-Trustees of the James and Angela Westmoreland Revocable Trust, or its assigns (the "*Noteholder*"), as the lender. James F. Westmoreland is the Company's Chairman, President and Chief Executive Officer. Pursuant to the Note, the Noteholder loaned the Company an aggregate principal amount of $155,548. After the deduction of loan fees of $10,929 the net proceeds from the loan were $144,619. The loan fees are being amortized as original issue discount (OID) over the term of the loan. The interest rate of the loan is 2.25%. The Note requires monthly payments on the Note balance until repaid in full. The maturity date of the Note is December 21, 2035. For the six months ended August 31, 2022, the Company made principal payments of $4,384 and amortized debt discount of $364. The obligations under the Note are secured by a lien on and security interest in the Company's crude oil assets located in Kern County, California, as described in a Deed of Trust entered into by the Company in favor of the Noteholder to secure the obligations under the Note. Such lien shall be a first priority lien, subject only to a pre-existing lien filed by a working interest partner of the Company.

The Company may prepay the Note at any time. Upon the occurrence of any Event of Default and expiration of any applicable cure period, and at any time thereafter during the continuance of such Event of Default, the Noteholder may at its option, by written notice to the Company: (a) declare the entire principal amount of the Note, together with all accrued interest thereon and all other amounts payable hereunder, immediately due and payable; (b) exercise any of its remedies with respect to the collateral set forth in the Deed of Trust; and/or (c) exercise any or all of its other rights, powers or remedies under applicable law.

Current portion of note payable – related party balances at August 31, 2022 and February 28, 2022 are set forth in the table below:

	August 31, 2022	February 28, 2022
Note payable – related party, current portion	$ 8,946	$ 8,829
Unamortized debt issuance expenses	(729)	(729)
Note payable – related party, current portion, net	$ 8,218	$ 8,100

Note payable – related party long-term balances at August 31, 2022 and February 28, 2022 are set forth in the table below:

	August 31, 2022	February 28, 2022
Note payable – related party, non-current	$ 132,207	$ 136,710
Unamortized debt issuance expenses	(8,985)	(9,350)
Note payable – related party, non-current, net	$ 123,222	$ 127,360

Future estimated payments on the outstanding note payable – related party are set forth in the table below:

Twelve month periods ending August 31,	
2023	$ 8,946
2024	9,186
2025	9,433
2026	9,686
2027	9,945
Thereafter	93,957
Total	$ 141,153

Short-term Convertible Note Payable

During the twelve months ended February 28, 2022, the Company executed a convertible promissory note with a third party for $200,000. The interest rate was 18% per annum and is payable in kind (PIK) solely by additional shares of the Company's common stock. Regardless of when the conversion occurred, a full 12 months of interest would be payable upon conversion. On May 5, 2022, the Company received notice of conversion of the promissory note. The face amount of the note and $36,000 in interest were converted at a rate of $0.0085 per share into 27,764,706 shares of the Company's common stock during the six months ended August 31, 2022.

12% Subordinated Notes

The Company's 12% Subordinated Notes ("the Notes") issued pursuant to a January 2010 private placement offering to accredited investors, resulted in $595,000 in gross proceeds (of which $250,000 was from a related party) to the Company and accrue interest at 12% per annum, payable semi-annually on January 29th and July 29th. On January 29, 2015, the Company and 12 of the 13 holders of the Notes agreed to extend the maturity date of the Notes for an additional two years to January 29, 2017. Effective January 29, 2017, the maturity date of the Notes and the expiration date of the warrants that were issued in conjunction with the Notes were extended for an additional two years to January 29, 2019.

As a result of the Company restructuring its balance sheet through conversions of related party debt to common stock, the related party 12% Noteholder, James F. Westmoreland, the Company's President and Chief Executive Officer, chose to convert the principal and accrued interest of their Notes to the Company's common stock. The related party Note for $250,000 and accrued interest of $264,986 were converted to common stock at a rate of approximately $0.45 for every dollar of principal and interest resulting in 1,144,415 shares of common stock being issued.

During the six months ended August 31, 2022, one 12% Note holder chose to convert the principal balance and accrued interest in to the Company's common stock. The $25,000 Note and accrued interest of $10,520 were converted at a rate of approximately $0.45 for every dollar of principal and interest resulting in 78,934 shares of common stock being issued.

The Company has informed the Note holders that the payment of principal and final interest will be late and is subject to future financing being completed and the Company's cash flow. The Notes principal of $290,000 has not been paid. The terms of the Notes, state that should the Board of Directors decide that the payment of the principal and any unpaid interest would impair the financial condition or operations of the Company, the Company may then elect a mandatory conversion of the unpaid principal and interest into the Company's common stock at a conversion rate equal to 75% of the average closing price of the Company's common stock over the 20 consecutive trading days preceding December 31, 2018. The accrued interest on the 12% Notes at August 31, 2022 and February 28, 2022 was $142,251 and $135,229, respectively.

12% Note balances at August 31, 2022 and February 28, 2022 are set forth in the table below:

	August 31, 2022	February 28, 2022
12% Subordinated Notes	$ 290,000	$ 315,000
12% Subordinated Notes – related party	—	—
Total 12% Subordinated Note balance	$ 290,000	$ 315,000

Line of Credit

The Company had an existing $890,000 line of credit for working capital purposes with UBS Bank USA (“UBS”), established pursuant to a Credit Line Agreement dated October 24, 2011 that was secured by the personal guarantee of its Chairman, President and Chief Executive Officer. On May 26, 2022, the Company paid off the outstanding balance of $809,930 on the line of credit. The payoff of the line of credit was previously approved under terms of the Equity Exchange Agreement in which the Company acquired the Reabold property in California. The payoff was a part of the use of proceeds from the Company’s sale of common stock to a third party.

Production Revenue Payable

Beginning in December 2018, the Company conducted a fundraising program to fund the drilling of future wells in California and Michigan and to settle some of its historical debt. The purchaser(s) of a production revenue payment interest received a production revenue payment on future wells to be drilled in California and Michigan in exchange for their purchase. The production payment interest entitles the purchasers to receive production payments equal to twice their original amount paid, payable from a percentage of the Company’s future net production payments from wells drilled after the date of the purchase and until the Production Payment Target (as described below) is met. The Company shall pay fifty percent of its net production payments from the relevant wells to the purchasers until each purchaser has received two times the purchase price (the “Production Payment Target”). Once the Company pays the purchasers amounts equal to the Production Payment Target, it shall thereafter pay a pro-rated eight percent (8%) of $1.3 million on its net production payments from the relevant wells to each of the purchasers. However, if the total raised is less than the target $1.3 million, then the payment will be a proportionate amount of the eight percent (8%). Additionally, if the Production Payment Target is not met within the first three years, the Company shall pay seventy-five percent of its production payments from the relevant wells to the purchasers until the Production Payment Target is met.

The Company accounted for the amounts received from these sales in accordance with ASC 470-10-25 and 470-10-35 which require amounts recorded as debt to be amortized under the interest method as described in ASC 835-30, Interest Method. Consequently, the program balance of $885,606 has been recognized as a production revenue payable. The Company determined an effective interest rate based on future expected cash flows to be paid to the holders of the production payment interests. This rate represents the discount rate that equates estimated cash flows with the initial proceeds received from the sales and is used to compute the amount of interest to be recognized each period. Estimating the future cash outflows under this agreement requires the Company to make certain estimates and assumptions about future revenues and payments and such estimates are subject to significant variability. Therefore, the estimates are likely to change which may result in future adjustments to the accretion of the interest expense and the amortized cost based carrying value of the related payables.

Accordingly, the Company has estimated the cash flows associated with the production revenue payments of $984,601 and determined a discount of $98,995 as of August 31, 2022, which is being accounted as interest expense over the estimated period over which payments will be made based on expected future revenue streams. For the six months ended August 31, 2022 and 2021, amortization of the debt discount on these payables amounted to $68,482 and $54,304, respectively, which has been included in interest expense in the statements of operations.

Production revenue payable balances at August 31, 2022 and February 28, 2022 are set forth in the table below:

	August 31, 2022	February 28, 2022
Estimated payments of production revenue payable	$ 984,601	$ 941,259
Less: unamortized discount	(98,994)	(124,134)
	885,607	817,125
Less: current portion	(251,734)	(78,877)
Net production revenue payable – long-term	$ 633,873	$ 738,248

Encumbrances

On October 17, 2018, a working interest partner in California filed a UCC financing statement in regards to payable amounts owed to the partner by the Company.

NOTE 9 — LEASES:

The Company leases approximately 988 rentable square feet of office space from an unaffiliated third party for our corporate office located in Spokane Valley, Washington. Additionally, we lease approximately 416 and 695 rentable square feet from unaffiliated third parties for our regional operations office in Friendswood, Texas and storage and auxiliary office space in Wallace, Idaho, respectively. The lease in Friendswood is a 12-month lease that expires on October 31, 2022 and as such is considered a short-term lease. The Company has elected to not apply the recognition requirements of ASC 842 to this short-term lease. The Spokane Valley and Wallace leases are currently on a month-to-month basis. The Company's lease agreements do not contain any residual value guarantees, restrictive covenants or variable lease payments. The Company has not entered into any financing leases.

Rent expense for the six months ended August 31, 2022 and 2021 was $11,895 and $11,895, respectively.

NOTE 10 — STOCKHOLDERS' EQUITY (DEFICIT):

Preferred Stock

With the filing of the Company's Second Amended and Restated Articles of Incorporation with the Washington Secretary of State in May 2022, the Company no longer has any preferred shares. The Company has only one class of stock, common stock.

Common Stock

The Company is authorized to issue up to 500,000,000 shares of $0.001 par value common stock of which 384,735,402 and 67,802,273 shares were issued and outstanding as of August 31, 2022 and February 28, 2022, respectively.

	Common Stock Balance	Par Value
Common stock, Issued and Outstanding, February 28, 2021	60,491,122	
Shares issued for Series A Preferred conversion	2,128,704	$ 2,129
Shares issued for Series A accumulated dividend	1,100,000	$ 1,100
Shares issued for debt conversion of accrued salaries	1,397,880	$ 1,398
Shares issued for debt conversion of accrued directors fees	317,708	$ 318
Shares issued for conversion of 12% Note principal and interest – related party	1,144,415	$ 1,144
Shares issued for investment principal in production revenue program	1,222,444	$ 1,222
Common stock, Issued and Outstanding, February 28, 2022	67,802,273	
Shares issued for conversion of 12% Note principal and interest	78,934	$ 79
Shares issued for conversion of convertible note	27,764,706	$ 27,765
Shares issued for acquisition of crude oil and natural gas properties	160,964,489	$ 160,964
Shares issued from sale of stock	128,125,000	$ 128,125
Common stock, Issued and Outstanding, August 31, 2022	384,735,402	

During the six months ended August 31, 2022, there were 316,933,129 shares of common stock issued in aggregate. There were 78,934 shares issued to a third party on conversion of a $25,000 12% Subordinated Note and $10,520 in accumulated interest. There were 27,764,706 shares issued on conversion of a $200,000 convertible note and $36,000 in accumulated interest. There were 160,964,489 shares issued for the acquisition of the Reabold California, LLC crude oil and natural gas properties. There were 128,125,000 shares issued through the sale of common stock to a third party, which then became a related party through the sale.

NOTE 11 — WARRANTS:

During the twelve months ended February 29, 2020 there were 2.1 million warrants issued to a third party for investor relations services. The fair value of the warrants was determined by the Black-Scholes pricing model, was $17,689, and is being amortized over the 3 year vesting period of the warrants. The Black-Scholes valuation encompassed the following assumptions: a risk free interest rate of 1.68%; volatility rate of 260.23%; and a dividend yield of 0.0%.

The warrants contains a vesting blocking provision that prevents the vesting of any warrants that such vesting would cause the warrant holder's beneficial ownership (as such term is defined in Section 13d-3 of the Securities Exchange Act of 1934, as amended) to exceed more than four and ninety-nine one-hundredths percent (4.99%) of the Company's outstanding Common Stock. The foregoing restriction may not be waived by either party. The warrants vested in equal parts over a three year period beginning on January 2, 2020 and were fully vested at January 2, 2022. The warrants expire on January 2, 2024.

As of August 31, 2022, there were 2,100,000 exercisable warrants. At August 31, 2022, both the outstanding warrants and the exercisable warrants have a weighted average exercise price of $0.01, a weighted average remaining life of 1.33 years. Both the outstanding warrants and the exercisable warrants have an intrinsic value of $84,000. For the six months ended August 31, 2022 and 2021, the recorded amount of warrant expense was $-0- and $1,474, respectively.

Warrant activity for the six months ended August 31, 2022 is set forth in the table below:

	Warrants		Weighted Average Exercise Price
Warrants outstanding, February 28, 2022	2,100,000	$	0.01
Changes during the six months ended August 31, 2022:			
Issued	—	$	—
Expired / cancelled / forfeited	—	$	—
Warrants outstanding, August 31, 2022	2,100,000	$	0.01
Warrants exercisable, August 31, 2022	2,100,000	$	0.01

NOTE 12 — INCOME TAXES:

On December 22, 2017, the federal government enacted a tax bill H.R.1, an act to provide for reconciliation pursuant to Titles II and V of the concurrent resolution on the budget for fiscal year 2018, commonly referred to as the Tax Cuts and Jobs Act. The Tax Cuts and Jobs Act contains significant changes to corporate taxation, including, but not limited to, reducing the U.S. federal corporate income tax rate from 35% to 21% and modifying or limiting many business deductions. The Company has re-measured its deferred tax liabilities based on rates at which they are expected to be utilized in the future, which is generally 21%.

Reconciliation between actual tax expense (benefit) and income taxes computed by applying the U.S. federal income tax rate and state income tax rates to income from continuing operations before income taxes is set forth in the table below:

		August 31, 2022		February 28, 2022
Computed at U.S. and state statutory rates	$	(424,910)	$	(118,897)
Permanent differences		23,232		11,157
Changes in valuation allowance		401,678		107,740
Total	$	—	$	—

Tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred liabilities are set forth in the table below:

		August 31, 2022		February 28, 2022
Deferred tax assets:				
Net operating loss carryforwards	$	6,076,666	$	5,670,900
Crude oil properties		83,606		87,694
Stock based compensation		66,187		66,187
Other		27,838		27,838
Less valuation allowance		(6,254,297)		(5,852,619)
Total	$	—	$	—

At August 31, 2022, the Company had estimated net operating loss (“NOL”) carryforwards for federal and state income tax purposes of approximately $20,364,166 which will begin to expire, if unused, beginning in 2024. Under the Tax Cuts and Jobs Act, the NOL portion of the loss incurred in the year ended February 28, 2018 of $340,749; the loss incurred in the year ended February 29, 2020 of $339,299; the loss incurred in the year ended February 28, 2021 of $416,898; the loss incurred in the year ended February 28, 2022 of $279,773; and the loss incurred for the six months ended August 31, 2022 in the amount of approximately $1,359,807 will not expire and will carry over indefinitely. The valuation allowance increased approximately $401,678 for the six months ended August 31, 2022 and increased approximately $107,740 for the year ended February 28, 2023, respectively. Section 382 of the Internal Revenue Code places annual limitations on the Company’s net operating loss (NOL) carryforward.

The above estimates are based on management's decisions concerning elections which could change the relationship between net income and taxable income. Management decisions are made annually and could cause estimates to vary significantly. The Company files federal income tax returns with the United States Internal Revenue Service and state income tax returns in various state tax jurisdictions. As a general rule the Company's tax returns for the fiscal years after 2016 currently remain subject to examinations by appropriate tax authorities. None of our tax returns are under examination at this time.

NOTE 13 — COMMITMENTS AND CONTINGENCIES:

Various lawsuits, claims and other contingencies arise in the ordinary course of the Company's business activities. While the ultimate outcome of any future contingency is not determinable at this time, management believes that any liability or loss resulting therefrom will not materially affect the financial position, results of operations or cash flows of the Company.

The Company, as an owner or lessee and operator of crude oil properties, is subject to various federal, state and local laws and regulations relating to discharge of materials into, and protection of, the environment. These laws and regulations may, among other things, impose liability on the lessee under a crude oil lease for the cost of pollution clean-up resulting from operations and subject the lessee to liability for pollution damages. In some instances, the Company may be directed to suspend or cease operations in the affected area. The Company maintains insurance coverage that is customary in the industry, although the Company is not fully insured against all environmental risks.

Sunflower Lawsuit

Sunflower Alliance v. California Department of Conservation, Geologic Energy Management Division. This case challenges the state agency's compliance with the California Environmental Quality Act (CEQA) with respect to the PAL Reabold 072-00-0001 Project, for wastewater injection into an existing well. The Petition was filed on December 29, 2021 in the Alameda County Superior Court. The Petitioner seeks an order setting aside the state agency's approval of a wastewater injection permit; damages are not sought in the lawsuit. On February 22, 2022, Real Party in Interest Reabold California, LLC filed a motion to transfer the case to the Contra Costa County Superior Court. On March 22, 2022, the Alameda County Superior Court ordered the case transferred to the Contra Costa County Superior Court. On August 15, 2022, the Contra Costa County Superior Court provided notice that the transfer has been completed and the case filed in that court. If successful, the lawsuit would prevent Reabold from injecting wastewater into an existing well until any CEQA deficiencies are addressed. The California Attorney General is defending the state agency, which disputes Petitioner's claims. At this time, it is unclear when the litigation will be resolved.

The Company is not aware of any environmental claims existing as of August 31, 2021. There can be no assurance, however, that current regulatory requirements will not change or that past non-compliance with environmental issues will not be discovered on the Company's crude oil properties.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is management's assessment of the current and historical financial and operating results of the Company and of our financial condition. It is intended to provide information relevant to an understanding of our financial condition, changes in our financial condition and our results of operations and cash flows and should be read in conjunction with our unaudited financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q for the six months ended August 31, 2022 and in our Annual Report on Form 10-K for the year ended February 28, 2022. References to "Daybreak", the "Company", "we", "us" or "our" mean Daybreak Oil and Gas, Inc.

Cautionary Statement Regarding Forward-Looking Statements

Certain statements contained in our Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") are intended to be covered by the safe harbor provided for under Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act.

All statements other than statements of historical fact contained in this MD&A report are inherently uncertain and are forward-looking statements. Statements that relate to results or developments that we anticipate will or may occur in the future are not statements of historical fact. Words such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "predict," "project," "will" and similar expressions identify forward-looking statements. Examples of forward-looking statements include, without limitation, statements about the following:

- Our future operating results;
- Our future capital expenditures;
- Our future financing;
- Our expansion and growth of operations; and
- Our future investments in and acquisitions of crude oil properties.

We have based these forward-looking statements on assumptions and analyses made in light of our experience and our perception of historical trends, current conditions, and expected future developments. However, you should be aware that these forward-looking statements are only our predictions and we cannot guarantee any such outcomes. Future events and actual results may differ materially from the results set forth in or implied in the forward-looking statements. Important factors that could cause actual results to differ materially from our expectations include, but are not limited to, the following risks and uncertainties:

- General economic and business conditions;
- National and international pandemics such as the novel coronavirus COVID-19 outbreak;
- Exposure to market risks in our financial instruments;
- Fluctuations in worldwide prices and demand for crude oil;
- Our ability to find, acquire and develop crude oil properties;
- Fluctuations in the levels of our crude oil exploration and development activities;
- Risks associated with crude oil exploration and development activities;
- Competition for raw materials and customers in the crude oil industry;
- Technological changes and developments in the crude oil industry;
- Legislative and regulatory uncertainties, including proposed changes to federal tax law and climate change legislation, regulation of hydraulic fracturing and potential environmental liabilities;
- Our ability to continue as a going concern;
- Our ability to secure financing under any commitments as well as additional capital to fund operations; and
- Other factors discussed elsewhere in this Form 10-Q; in our other public filings and press releases; and discussions with Company management.

Our reserve estimates are determined through a subjective process and are subject to revision.

Should one or more of the risks or uncertainties described above or elsewhere in our Form 10-K for the year ended February 28, 2022 and in this Form 10-Q for the six months ended August 31, 2022 occur, or should any underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements. We specifically undertake no obligation to publicly update or revise any information contained in any forward-looking statement or any forward-looking statement in its entirety, whether as a result of new information, future events, or otherwise, except as required by law.

All forward-looking statements attributable to us are expressly qualified in their entirety by this cautionary statement.

Introduction and Overview

We are an independent crude oil and natural gas exploration, development and production company. Our basic business model is to increase shareholder value by finding and developing crude oil and natural gas reserves through exploration and development activities, and selling the production from those reserves at a profit. To be successful, we must, over time, be able to find crude oil and natural gas reserves and then sell the resulting production at a price that is sufficient to cover our finding costs, operating expenses, administrative costs and interest expense, plus offer us a return on our capital investment. A secondary means of generating returns can include the sale of either producing or non-producing lease properties.

Our longer-term success depends on, among many other factors, the acquisition and drilling of commercial grade crude oil and natural gas properties and on the prevailing sales prices for crude oil and natural gas along with associated operating expenses. The volatile nature of the energy markets makes it difficult to estimate future prices of crude oil and natural gas; however, any prolonged period of depressed prices or market volatility, such as we have experienced in the last 18 months, will have a material adverse effect on our results of operations and financial condition.

Our operations are focused on identifying and evaluating prospective crude oil and natural gas properties and funding projects that we believe have the potential to produce crude oil and natural gas in commercial quantities. We conduct all of our drilling, exploration and production activities in the United States, and all of our revenues are derived from sales to customers within the United States. Currently, we are in the process of developing a multi-well oilfield project in Kern County, California.

Our management cannot provide any assurances that Daybreak will ever operate profitably. While, in the past, we have had positive cash flow from our crude oil operations in the East Slopes project in California, we have not yet generated sustainable positive cash flow or earnings on a company-wide basis. As a small company, we are more susceptible to the numerous business, investment and industry risks that have been described in Item 1A. Risk Factors of our Annual Report on Form 10-K for the fiscal year ended February 28, 2022 and in Part III, Item 1A. Risk Factors of this 10-Q Report. Throughout this Quarterly Report on Form 10-Q, crude oil is shown in barrels ("Bbls"); natural gas is shown in thousands of cubic feet ("Mcf") unless otherwise specified, and hydrocarbon totals are expressed in barrels of crude oil equivalent ("BOE").

Below is brief summary of our two crude oil and natural gas projects in California. Refer to our discussion in Item 2. Properties, in our Annual Report on Form 10-K for the year ended February 28, 2022 for more information on our multi-well oilfield East Slopes project in California.

Kern County, California (East Slopes Project)

The East Slopes Project is located in the southeastern part of the San Joaquin Basin near Bakersfield, California. Drilling targets are porous and permeable sandstone reservoirs that exist at depths of 1,200 feet to 4,500 feet. Since January 2009, we have participated in the drilling of 25 wells in this project. We have been the Operator at the East Slopes Project since March 2009.

The crude oil produced from our acreage in the Vedder Sand is considered heavy oil. The gravity of the crude oil ranges from 14° to 16° API (American Petroleum Institute) gravity and must be heated to separate and remove water prior to sale. Our crude oil wells in the East Slopes Project produce from five reservoirs at our Sunday, Bear, Black, Ball and Dyer Creek locations. The Sunday property has six producing wells, while the Bear property has nine producing wells. The Black property is the smallest of all currently producing reservoirs, and currently has two producing wells at this property. The Ball property also has two producing wells while the Dyer Creek property has one producing well. During the six months ended August 31, 2021 we had production from 20 crude oil wells. Our average working interest ("WI") and net revenue interest ("NRI") in these 20 wells is 36.6% and 27.6%, respectively.

We plan on acquiring additional acreage exhibiting the same seismic characteristics and on trend with the Bear, Black and Dyer Creek reservoirs. Some of these prospects, if successful, would utilize the Company's existing production facilities. In addition to the current field development, there are several other exploratory prospects that have been identified from the seismic data, which we plan to drill in the future.

California Drilling Plans

We are currently in the planning and permitting process to undertake a multi-well developmental drilling program commencing in the late fall of 2022 or first quarter of 2023. These plans are dependent on a stabilization of crude oil prices. We plan to spend approximately $435,000 drilling three development wells in the current 2022-2023 fiscal year.

Monterey and Contra Costa Counties, California (Reabold California, LLC)

In May 2022, we acquired Reabold California, LLC ("Reabold") from a third party. This property includes producing wells in both Monterey and Contra Costa counties of California.

The Burnett Lease and the Doud Lease are located in close proximity to each another in Monterey County. They are part of a geological feature named the Monroe Swell. The Burnett Lease presently has two directional wells that are being produced from a depth of 2,900' from the Beedy Sand zone. The oil being produced is 19° gravity. We have future plans of drilling one horizontal well on this lease and to convert and old well bore into a salt water disposal well ("SWDW"). The Doud Lease has four directional well bores with three of those being produced from a depth of 3,300' from the Doud A Sand zone. The oil being produced is 22° gravity. We have future plans of drilling one additional directional well on this lease. The SWDW for the Burnett Lease will be utilized for the Doud lease as well.

The Brentwood Lease is located in Contra-Costa County. This lease is part of a geological feature named the Meganos Unconformity. There are presently two directional wells producing from this lease. Additionally, another well bore will be worked over after a SWDW permit has been approved before putting it back in production. The wells are producing from the Second Massive Sand from a depth of between 4,000'- 4,500'. The oil being produced is 32° gravity. A work over was successfully completed on one well to decrease water production and to increase oil production. It will be brought back into production when the SWDW is completed.

Sunflower Lawsuit

Sunflower Alliance v. California Department of Conservation, Geologic Energy Management Division. This case challenges the state agency's compliance with the California Environmental Quality Act (CEQA) with respect to the PAL Reabold 072-00-0001 Project, for wastewater injection into an existing well. The Petition was filed on December 29, 2021 in the Alameda County Superior Court. The Petitioner seeks an order setting aside the state agency's approval of a wastewater injection permit; damages are not sought in the lawsuit. On February 22, 2022, Real Party in Interest Reabold California, LLC filed a motion to transfer the case to the Contra Costa County Superior Court. On March 22, 2022, the Alameda County Superior Court ordered the case transferred to the Contra Costa County Superior Court. On August 15, 2022, the Contra Costa County Superior Court provided notice that the transfer has been completed and the case filed in that court. If successful, the lawsuit would prevent Reabold from injecting wastewater into an existing well until any CEQA deficiencies are addressed. The California Attorney General is defending the state agency, which disputes Petitioner's claims. At this time, it is unclear when the litigation will be resolved.

The Company is not aware of any environmental claims existing as of August 31, 2021. There can be no assurance, however, that current regulatory requirements will not change or that past non-compliance with environmental issues will not be discovered on the Company's crude oil properties.

Encumbrances

On October 17, 2018, a working interest partner in the East Slopes Project in California filed a UCC financing statement in regards to payables owed to the partner by the Company.

Results of Operations – Six months ended August 31, 2022 compared to the six months ended August 31, 2021

California Crude Oil Prices

The prices we receive for crude oil sales in California from the East Slopes project and from Reabold California, LLC ("Reabold") are based on prices posted for Midway-Sunset and Buena Vista crude oil delivery contracts, respectively. All posted pricing is subject to adjustments that vary by grade of crude oil, transportation costs, market differentials and other local conditions. Both the posted Midway-Sunset and Buena Vista prices generally move in correlation to prices quoted on the New York Mercantile Exchange (NYMEX") for spot West Texas intermediate ("WTI") crude oil, Cushing, Oklahoma delivery contracts.

California Natural Gas Prices

The price we receive for natural gas sales from Reabold is based on ninety-five (95%) of the price published in Natural Gas Intelligence ("NGI") Gas Price Index under the column "Bidweek Averages" for "California", "PG&E Citygate" less an amount per MMBtu equal to the Silverado Path On System As-Available transport date, less the Silverado Path On System transmission shrinkage rate for Silverado. The price we receive generally moves in correlation to prices quoted on the New York Mercantile Exchange (NYMEX") for spot Henry Hub natural gas prices.

There continues to be a significant amount of volatility in hydrocarbon prices and a corresponding fluctuation in our realized sale price of crude oil does exist. An example of this volatility is that in June of 2014 the monthly average price of WTI oil was $105.79 per barrel and our realized price per barrel of crude oil was $98.78 while in April 2020, the monthly average price of WTI crude oil was $16.55 and our monthly realized price was $16.96 per barrel. Finally, in August 2022, the monthly average price of WTI oil was $93.67 per barrel and our realized price per barrel of crude oil was $92.43. This volatility in crude oil prices has continued throughout most of the fiscal year ended February 28, 2023. Any downward volatility in the price of crude oil will have a prolonged and substantial negative impact on our profitability and cash flow from our producing California properties. It is beyond our ability to accurately predict crude oil prices over any substantial length of time.

A comparison of the average WTI crude oil price and the average realized crude oil sales price for the six months ended August 31, 2022 and 2021 is shown in the table below:

	Six Months Ended August 31, 2022	Six Months Ended August 31, 2021	Percentage Change
Average six month WTI crude oil price (Bbl)	$ 104.99	$ 66.80	57.2%
Average six month realized crude oil sales price (Bbl)	$ 102.97	$ 64.77	59.0%

For the six months ended August 31, 2022, the average WTI price was $104.99 and our average realized crude oil sale price was $102.97, representing a discount of $2.02 per barrel or 1.9% lower than the average WTI price. In comparison, for the six months ended August 31, 2021, the average WTI price was $66.80 and our average realized sale price was $64.77 representing a discount of $2.03 per barrel or 3.0% lower than the average WTI price. Historically, the sale price we receive for East Slopes crude oil has been less than the quoted WTI price because of the lower API gravity of our East Slopes crude oil in comparison to the API gravity of quoted WTI crude oil.

California Crude Oil Revenue and Production

Crude oil revenue in California for the six months ended August 31, 2022 increased $462,579 or 146.1% to $779,197 in comparison to revenue of $316,618 for the six months ended August 31, 2021. The reason for the increase was the acquisition of the Reabold wells in central California. The average sale price of a barrel of crude oil for the six months ended August 31, 2022 was $102.97 in comparison to $64.77 for the six months ended August 31, 2021. The 2019 novel coronavirus ("COVID-19") that has spread throughout the world including the United States had a substantial negative impact on the demand for crude oil and was largely responsible for the volatility in crude oil prices for the last 18 months. The increase of $38.20 or 59.0% per barrel in the average realized price of a barrel of crude oil accounted for 40.4% of the increase in crude oil revenue for the six months ended August 31, 2022.

Our net crude oil sales volume for the six months ended August 31, 2022 was 7,567 barrels of crude oil in comparison to 4,888 barrels sold for the six months ended August 31, 2021. This increase in crude oil sales volume of 2,679 barrels or 54.8% was primarily due to our acquisition of the Reabold property and its producing wells in central California. The gravity of our produced crude oil in the East Slopes project ranges between 14° API and 16° API. The gravity of our produced crude oil in the Reabold project ranges between 17° API and 38° API.

Our crude oil sales revenue for the six months ended August 31, 2022 and 2021 are set forth in the following table:

	Six Months Ended August 31, 2022		Six Months Ended August 31, 2021	
Project	Revenue	Percentage	Revenue	Percentage
East Slopes Project – crude oil sales	$ 440,039	56.5%	$ 316,618	100.0%
Reabold Project – crude oil sales	338,859	43.5%	—	—
California Totals	$ 778,898	100.0%	$ 316,618	100.0%

Our natural gas sales revenue for the six months ended August 31, 2022 and 2021 is set forth in the following table:

	Six Months Ended August 31, 2022		Six Months Ended August 31, 2021	
Project	Revenue	Percentage	Revenue	Percentage
Reabold Project – natural gas sales	$ 9,748	100.0%	$ —	—

Our average realized sale price on a BOE basis of crude oil and natural gas for the six months ended August 31, 2022 was $102.00 in comparison to $64.77 for the six months ended August 31, 2021, representing an increase of $37.23 or 57.5% per barrel.

Operating Expenses

Total operating expenses for the six months ended August 31, 2022 were $2,074,034, an increase of $1,658,668 or 399.3% compared to $415,366 for the six months ended August 31, 2021. Operating expenses for the six months ended August 31, 2022 and 2021 are set forth in the table below:

	Six Months Ended August 31, 2022			Six Months Ended August 31, 2021		
	Expenses	**Percentage**	**BOE Basis**	**Expenses**	**Percentage**	**BOE Basis**
Production expenses	$ 359,199	17.3%		$ 99,569	24.0%	
Exploration and drilling expenses	1,170	0.1%		201	0.0%	
Depreciation, depletion, amortization (“DD&A”)	149,664	7.2%		28,808	6.9%	
Transaction (acquisition) expenses	1,025,541	49.4%		—	—	
General and administrative (“G&A”) expenses	538,460	26.0%		286,788	69.1%	
Total operating expenses	$ 2,074,034	100.0%	$ 268.24	$ 415,366	100.0%	$ 84.98

Production expenses include expenses associated with the production of crude oil. These expenses include contract pumpers, electricity, road maintenance, control of well insurance, property taxes and well workover expenses; and, relate directly to the number of wells that are in production. For the six months ended August 31, 2022, these expenses increased by $259,630 or 260.8% to $359,199 in comparison to $99,569 for the six months ended August 31, 2021. For the six months ended August 31, 2022, we had 24 wells on production from the East Slopes and Reabold projects in comparison to 20 wells on production in the East Slopes project for the six months ended August 31, 2021. The increase of four wells was from the Reabold acquisition that occurred in late May 2022. The increase in production expenses for the six months ended August 31, 2022, was primarily due to the replacement and upgrading of pumps in seven wells of the East Slopes project for $42,920 and the expenses associated with salt water disposal of $158,100 from the Reabold project. A salt water disposal well is currently being permitted which, when put into operation will significantly lower operating costs of the Reabold project. Production expense on a barrel of oil equivalent (“BOE”) basis for the six months ended August 31, 2022 and 2021 were $46.46 and $20.37, respectively. Production expenses represented 17.3% and 24.0% of total operating expenses for the six months ended August 31, 2022 and 2021, respectively.

Exploration and drilling expenses include geological and geophysical (“G&G”) expenses as well as leasehold maintenance, plugging and abandonment (“P&A”) expenses and dry hole expenses. For the six months ended August 31, 2022 and 2021, these expenses were $1,170 and $201, respectively. Exploration and drilling expenses represented 0.1% and 0.0% of total operating expenses for the six months ended August 31, 2022 and 2021, respectively.

Depreciation, depletion and amortization (“DD&A”) expenses relate to equipment, proven reserves and property costs, along with impairment, and is another component of operating expenses. For the six months ended August 31, 2022, DD&A expenses increased $120,856 or 419.5% to $149,664 in comparison to $28,808 for the six months ended August 31, 2021. On a BOE basis, DD&A expense was $19.36 and $5.89 for the six months ended August 31, 2022 and 2021, respectively. DD&A expenses represented 7.2% and 6.9% of total operating expenses for the six months ended August 31, 2022 and 2021, respectively.

For the six months ended August 31, 2022, we incurred transaction expenses of $1,025,541 related to the acquisition of funding and to acquire the Reabold crude oil and natural gas properties located in central California and to eliminate our line of credit balance. For the six months ended August 31, 2021, we did not incur any related expenses. Transaction expenses represented 49.4% and 0.0% of total operating expenses for the six months ended August 31, 2022 and 2021, respectively.

General and administrative (“G&A”) expenses include the salaries of six employees, including management. Other items included in our G&A expenses are legal and accounting expenses, investor relations fees, travel expenses, insurance expenses and other administrative expenses necessary for an operation of crude oil and natural gas properties as well as for the running a public company. For the six months ended August 31, 2022, G&A expenses increased $251,672 or 87.8% to $538,460 in comparison to $286,788 for the six months ended August 31, 2021. The primary reasons for the increase in G&A expense are related to the expenses of both the special shareholders and the annual shareholders meetings, in the amount of approximately $122,200 in aggregate, that were held during the six months ended August 31, 2022 and professional legal and accounting fees of approximately $70,000 related to the Reabold acquisition. We are continuing a program of controlling our G&A costs wherever possible. G&A expenses represented 26.0% and 69.1% of total operating expenses for the six months ended August 31, 2022 and 2021, respectively.

During the six months ended August 31, 2021, the Company recognized a gain on asset disposal of $9,614. The gain was the result of an insurance settlement on the theft of a company vehicle that was fully depreciated.

Interest expense, net for the six months ended August 31, 2022 increased $22,979 or 19.9% to $138,576 in comparison to $115,597 for the six months ended August 31, 2021.

Results of Operations – Three months ended August 31, 2022 compared to the three months ended August 31, 2021

A comparison of the average WTI crude oil price and the average realized crude oil sales price for the three months ended August 31, 2022 and 2021 is shown in the table below:

	Three Months Ended		
	August 31, 2022	August 31, 2021	Percentage Change
Average three month WTI crude oil price (Bbl)	$ 103.38	$ 70.52	46.4%
Average three month realized crude oil sales price (Bbl)	$ 101.56	$ 67.75	49.9%

For the three months ended August 31, 2022, the average WTI price was $103.38 and our average realized crude oil sale price was $101.56, representing a discount of $1.82 per barrel or 1.8% lower than the average WTI price. In comparison, for the three months ended August 31, 2021, the average WTI price was $70.52 and our average realized sale price was $67.75 representing a discount of $2.77 per barrel or 3.9% lower than the average WTI price. Historically, the sale price we receive for East Slopes heavy crude oil has been less than the quoted WTI price because of the lower API gravity of our California crude oil in comparison to the API gravity of quoted WTI crude oil.

California Crude Oil Revenue and Production

Crude oil revenue in California for the three months ended August 31, 2022, increased $362,264 or 214.0% to $531,582 in comparison to revenue of $169,318 for the three months ended August 31, 2021. The primary reason for the increase was the acquisition of the Reabold wells in central California. The average sale price of a barrel of crude oil for the three months ended August 31, 2022 was $101.56 in comparison to $67.75 for the three months ended August 31, 2021. The increase of $33.81 or 49.9% per barrel in the average realized price of a barrel of crude oil accounted for 23.3% of the increase in crude oil revenue for the three months ended August 31, 2022.

Our net sales volume for the three months ended August 31, 2022 was 5,234 barrels of crude oil in comparison to 2,499 barrels sold for the three months ended August 31, 2021. This increase in crude oil sales volume of 2,735 barrels or 109.4% was due to our acquisition of the Reabold property and its producing wells in central California. The gravity of our produced crude oil in the East Slopes project ranges between 14° API and 16° API. The gravity of our produced crude oil in the Reabold project ranges between 17° API and 38° API.

Our crude oil sales revenue for the three months ended August 31, 2022 and 2021 are set forth in the following table:

	Three Months Ended August 31, 2022		Three Months Ended August 31, 2021	
Project	Revenue	Percentage	Revenue	Percentage
East Slopes Project – crude oil sales	$ 192,424	36.2%	$ 169,318	100.0%
Reabold Project – crude oil sales	338,859	63.8%	—	—
California Totals	$ 531,283	100.0%	$ 169,318	100.0%

Our natural gas sales revenue for the three months ended August 31, 2022 and 2021 is set forth in the following table:

	Three Months Ended August 31, 2022		Three Months Ended August 31, 2021	
Project	Revenue	Percentage	Revenue	Percentage
Reabold Project – natural gas sales	$ 9,748	100.0%	$ —	—

Our average realized sale price on a BOE basis of crude oil and natural gas for the three months ended August 31, 2022 was $100.21 in comparison to $67.75 for the three months ended August 31, 2021, representing an increase of $32.46 or 47.9% per barrel.

Operating Expenses

Total operating expenses for the three months ended August 31, 2022 were $723,862, an increase of $536,795 or 287.0% compared to $187,067 for the three months ended August 31, 2021. Operating expenses for the three months ended August 31, 2022 and 2021 are set forth in the table below:

	Three Months Ended August 31, 2022			Three Months Ended August 31, 2021		
	Expenses	**Percentage**	**BOE Basis**	**Expenses**	**Percentage**	**BOE Basis**
Production expenses	$ 298,482	41.2%		$ 52,843	28.3%	
Exploration and drilling expenses	1,170	0.2%		201	0.1%	
Depreciation, depletion, amortization (“DD&A”)	137,888	19.0%		14,860	7.9%	
General and administrative (“G&A”) expenses	286,322	39.6%		119,163	63.7%	
Total operating expenses	$ 723,862	100.0%	$ 134.07	$ 187,067	100.0%	$ 74.86

Production expenses for the three months ended August 31, 2022, increased by $245,639 or 464.8% to $298,482 in comparison to $52,843 for the three months ended August 31, 2021. For the three months ended August 31, 2022 and 2021, we had 19 and 20 wells, respectively, on production in our East Slopes project. For the three months ended August 31, 2022, we had four wells on production in the Reabold project that we acquired in May 2022. The increase in production expenses for the three months ended August 31, 2022, was primarily due to the replacement and upgrading of pumps in seven wells of the East Slopes project for $42,920 and the expenses associated with salt water disposal of $158,100 from the Reabold project. A salt water disposal well is currently being permitted which, when put into operation will significantly lower operating costs of the Reabold project. Production expense on a barrel of oil equivalent (“BOE”) basis for the three months ended August 31, 2022 and 2021 were $55.28 and $21.15, respectively. Production expenses represented 41.2% and 28.3% of total operating expenses for the three months ended August 31, 2022 and 2021, respectively.

Exploration and drilling expenses for the three months ended August 31, 2022 were $1,170 in comparison to $201 for the three months ended August 31, 2021. Exploration and drilling expenses represented 0.1% and 0.1% of total operating expenses for the three months ended August 31, 2022 and 2021, respectively.

DD&A expenses for the three months ended August 31, 2022, increased $123,028 or 827.9% to $137,888 in comparison to $14,860 for the three months ended August 31, 2021. DD&A on a BOE basis was $25.54 and $5.95 for the three months ended August 31, 2022 and 2021, respectively. DD&A expenses represented 19.0% and 7.9% of total operating expenses for the three months ended August 31, 2022 and 2021, respectively.

General and administrative (“G&A”) expenses include the salaries of five employees, including management. Other items included in our G&A expenses are legal and accounting expenses, investor relations fees, travel expenses, insurance expenses and other administrative expenses necessary for an operator of crude oil properties as well as for running a public company. G&A expenses for the three months ended August 31, 2022, increased $167,159 or 140.3% to $286,322 in comparison to $119,163 for the three months ended August 31, 2021. The primary reasons for the increase in G&A expense are related to the special shareholders meeting held during the three months ended May 31, 2022 and the annual shareholders meeting held during the three months ended August 31, 2022 in the amount of approximately $54,200 in aggregate and professional legal and accounting services of approximately $61,000 related to the Reabold acquisition on May 2022. We are continuing a program of controlling our G&A costs wherever possible. G&A expenses represented 39.6% and 63.7% of total operating expenses for the three months ended August 31, 2022 and 2021, respectively.

Interest expense, net for the three months ended August 31, 2022 increased $13,315 or 24.5% to $67,646 in comparison to $54,331 for the three months ended August 31, 2021.

Due to the nature of our business, we expect that revenues, as well as all categories of expenses, will continue to fluctuate substantially on a quarter-to-quarter and year-to-year basis. Revenues are highly dependent on the volatility of hydrocarbon prices and production volumes. Production expenses will fluctuate according to the number and percentage ownership of producing wells as well as the amount of revenues we receive based on the price of crude oil. Exploration and drilling expenses will be dependent upon the amount of capital that we have to invest in future development projects, as well as the success or failure of such projects. Likewise, the amount of DD&A expense will depend upon the factors cited above including the size of our proven reserves base and the market price of energy products. G&A expenses will also fluctuate based on our current requirements, but will generally tend to increase as we expand the business operations of the Company. An on-going goal of the Company is to improve cash flow to cover the current level of G&A expenses and to fund our drilling programs in California and Michigan.

Capital Resources and Liquidity

Our primary financial resource is our proven crude oil reserve base. Our ability to fund any future capital expenditure programs is dependent upon the prices we receive from crude oil sales, the success of our drilling programs in California and the availability of capital resource financing. There continues to be a significant amount of volatility in crude oil prices and dramatic fluctuation in our realized sale price of crude oil since June of 2014, when the monthly average price of WTI crude oil was $105.79 per barrel, and our realized sale price per barrel of crude oil was $98.78. As an example, for the month of April 2020 the monthly average closing price of WTI crude oil was $16.55 and our monthly realized oil price was $16.96 per barrel. Finally, in May 2022, the monthly average price of WTI oil was $109.55 per barrel and our realized price per barrel of crude oil was $106.56. Again in August, 2022, our average realized price was $92.36 per barrel. This volatility in crude oil prices continued into the current fiscal year. Any downward volatility in the price of crude oil will have a prolonged and substantial negative impact on our profitability and cash flow from our producing California properties. It is beyond our ability to accurately predict crude oil prices over any substantial length of time.

We plan to spend approximately $435,000 drilling three development wells in the current 2022-2023 fiscal year; however our actual expenditures may vary significantly from this estimate if our plans for exploration and development activities change during the year. Factors such as changes in operating margins and the availability of capital resources could increase or decrease our ultimate level of expenditures during the current fiscal year.

Changes in our capital resources at August 31, 2022 in comparison to February 28, 2022 are set forth in the table below:

	August 31, 2022	February 28, 2022	Increase (Decrease)	Percentage Change
Cash	$ 412,949	$ 139,573	$ 273,376	195.9%
Restricted Cash	$ 275,000	$ —	$ 275,000	100.0 %
Current assets	$ 1,240,430	$ 416,651	$ 823,779	197.7%
Total assets	$ 8,562,095	$ 975,704	$ 7,586,391	777.5%
Current liabilities	$ (2,861,272)	$ (3,404,735)	$ (543,463)	(16.0%)
Total liabilities	$ (3,834,074)	$ (4,322,908)	$ (488,834)	(11.3%)
Working capital	$ (1,620,842)	$ (2,988,084)	$ (1,367,242)	(45.8%)

Our working capital deficit decreased approximately $1.37 million or 45.8% to approximately $1.6 million at August 31, 2022 in comparison to approximately $2.99 million at February 28, 2022. The decrease in our working capital deficit was primarily due to the proceeds we received in connection with the sale of common stock. We anticipate an increase in our cash flow will occur when we are able to return to our planned drilling program that will result in an increase in the number of wells on production.

Our business is capital intensive. Our ability to grow is dependent upon favorably obtaining outside capital and generating cash flows from operating activities necessary to fund our investment activities. There is no assurance that we will be able to achieve profitability. Since our future operations will continue to be dependent on successful exploration and development activities and our ability to seek and secure capital from external sources, should we be unable to achieve sustainable profitability this could cause any equity investment in the Company to become worthless.

Major sources of funds in the past for us have included the debt or equity markets and the sale of assets. We anticipate that we will have to rely on these capital markets to fund future operations and growth. Our business model is focused on acquiring exploration or development properties as well as existing production. Our ability to generate future revenues and operating cash flow will depend on successful exploration, and/or acquisition of crude oil producing properties, which may very likely require us to continue to raise equity or debt capital from outside sources.

Daybreak has ongoing capital commitments to develop certain leases pursuant to their underlying terms. Failure to meet such ongoing commitments may result in the loss of the right to participate in future drilling on certain leases or the loss of the lease itself. These ongoing capital commitments will cause us to seek additional forms of financing through various methods, including issuing debt securities, equity securities, bank debt, or combinations of these instruments which could result in dilution to existing security holders and increased debt and leverage. The current uncertainty in the credit and capital markets as well as the instability and volatility in crude oil prices since June of 2014, has restricted our ability to obtain needed capital. The 2019 novel coronavirus ("COVID-19") that spread to countries throughout the world including the United States had a substantial negative impact on the demand for crude oil and is largely responsible for the decline in crude oil prices. No assurance can be given that we will be able to obtain funding under any loan commitments or any additional financing on favorable terms, if at all. Sales of interests in our assets may be another source of cash flow available to us.

The Company's financial statements for the six months ended August 31, 2022 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. We have incurred net losses since entering the crude oil exploration industry in 2005, and as of the six months ended August 31, 2022, we have an accumulated deficit of $30.95 million and a working capital deficit of $1.6 million which raises substantial doubt about our ability to continue as a going concern.

In the current fiscal year, we will need to seek additional financing for our planned exploration and development activities in California. We could obtain financing through one or more various methods, including issuing debt securities, equity securities, or bank debt, or combinations of these instruments, which could result in dilution to existing security holders and increased debt and leverage. No assurance can be given that we will be able to obtain funding under any loan commitments or any additional financing on favorable terms, if at all. Sales of interests in our assets may be another source of cash flow.

Changes in Financial Condition

During the six months ended August 31, 2021, we received crude oil sales revenue from our 20 producing wells in the East slopes project as well as crude oil and natural gas sales revenue from four producing wells in the recently acquired Reabold project. Both of these projects are located in California. Our commitment to improving corporate profitability remains unchanged. We experienced an increase in revenues of $472,028 or 149.1% to $788,646 for the six months ended August 31, 2022 in comparison to revenues of $316,618 for the six months ended August 31, 2021. The increase of $37.23 or 57.5% in the average realized price BOE accounted for 38.6% of the increase in crude oil revenue for the six months ended August 31, 2022. The increase in sales volume BOE accounted for the remaining 61.5% of the revenue increase. The increase in volume was primarily due to the four producing wells that we acquired in the recently completed acquisition of Reabold California, LLC. For the six months ended August 31, 2022, we had an operating loss of $1,285,388 in comparison to an operating loss of $98,748 for the six months ended August 31, 2021. The increase in the operating loss was due to transaction expenses related to the acquisition of the Reabold property, fundraising, and the expenses of holding both a special shareholders' meeting to approve the acquisition and a regular annual shareholders meeting.

Our balance sheet at August 31, 2022 reflects total assets of approximately $8.56 million in comparison to approximately $0.98 million at February 28, 2022. The increase of approximately $7.5 million is directly related to the acquisition of crude oil and natural gas assets in California.

At August 31, 2022, total liabilities were approximately $3.8 million in comparison to approximately $4.3 million at February 28, 2022. The decrease in liabilities of approximately $488,000 was primarily due elimination of the line of credit with UBS Bank in conjunction with the completion of the sale of common stock through a private sale.

At August 31, 2022, there were 384,735,402 issued and outstanding shares of common stock in comparison to 67,802,273 shares at February 28, 2022. The increase in shares issued and outstanding of 316,933,129 shares was directly related to the acquisition of producing crude oil and natural gas assets, associated fundraising and the restructuring of our balance sheet eliminating debt in exchange for equity.

Additional paid in capital (APIC) increased approximately $9.2 million at August 31, 2022 to $35,297,706 from $26,115,450 at February 28, 2022, as a result of the same acquisition of producing crude oil and natural gas assets, associated fundraising and the restructuring of our balance sheet eliminating debt in exchange for equity.

Cash Flows

Changes in the net funds provided by and (used in) our operating, investing and financing activities are set forth in the table below:

	Six Months Ended August 31, 2022	Six Months Ended August 31, 2021	Increase (Decrease)	Percentage Change
Net cash (used in) provided by operating activities	$ (592,183)	$ 41,329	(633,512)	(1,532.9%)
Net cash (used in) investing activities	$ —	$ (13,107)	13,107	N/A
Net cash provided by (used in) financing activities	$ 1,140,559	$ (4,611)	1,145,170	24,835.6%

Cash Flow Provided By (Used In) Operating Activities

Cash flow from operating activities is derived from the production of our crude oil reserves and changes in the balances of non-cash accounts, receivables, payables or other non-energy property asset account balances. For the six months ended August 31, 2022, cash flow used in operating activities was $592,183 in comparison to cash flow provided by operating activities of $41,329 for the six months ended August 31, 2021. The increase in our cash flow used in operating activities of

633,512 for the six months ended August 31, 2022 was primarily due to increases in our accounts receivable crude oil and natural gas sales and receivables form our working interest partners. Both of these increases were directly related to our acquisition of producing crude oil and natural gas assets in California from a third party. Changes in non-cash account balances primarily relating to financing fees, DD&A and amortization of debt discount increased by approximately $644,000 in comparison to the six month ended August 31, 2021. Variations in cash flow from operating activities may impact our level of exploration and development expenditures.

Cash Flow Used In Investing Activities

Cash flow from investing activities is derived from changes in crude oil property balances and any lending activities. Cash flow used in our investing activities for the six months ended August 31, 2022 was $-0- in comparison to cash flow used in our investing activities of $13,107 for the six months ended August 31, 2021.

Cash Flow Provided By (Used In) Financing Activities

Cash flow from financing activities is derived from changes in long-term liability account balances or in equity account balances, excluding retained earnings. Cash flow provided by our financing activities was $1,140,559 for the six months ended August 31, 2022 in comparison to cash flow used in our financing activities of $4,611 for the six months ended August 31, 2021. During the six months ended August 31, 2022 we secured a capital raise of $1,987,500 net of transaction expenses from the sale of 128,125,000 shares of our common stock. Additionally, during the six months ended August 31, 2022, we paid off the balance of $808,182 on the line of credit with UBS Bank.

The following discussion is a summary of cash flows provided by, and used in, the Company's financing activities at August 31, 2022.

SHORT-TERM AND LONG-TERM BORROWINGS:

Note Payable

In December 2018, the Company was able to settle an outstanding balance owed to one of its third-party vendors. This settlement resulted in a $120,000 note payable being issued to the vendor. Additionally, the Company agreed to issue 2,000,000 shares of the Company's common stock as a part of the settlement agreement. Based on the closing price of the Company's common stock on the date of the settlement agreement, the value of the common stock transaction was determined to be $6,000. The common stock shares were issued during the twelve months ended February 29, 2020. The note has a maturity date of January 1, 2022 and bears an interest rate of 10% rate per annum. Monthly interest is accrued and payable on January 1st of each anniversary date until maturity of the note. At August 31, 2022, the accrued interest had not been paid and was outstanding. The accrued interest on the Note was $44,000 and $38,000 at August 31, 2022 and February 28, 2022, respectively.

Note Payable – Related Party

On December 22, 2020, the Company entered into a Secured Promissory Note (the "*Note*"), as borrower, with James Forrest Westmoreland and Angela Marie Westmoreland, Co-Trustees of the James and Angela Westmoreland Revocable Trust, or its assigns (the "*Noteholder*"), as the lender. James F. Westmoreland is the Company's Chairman, President and Chief Executive Officer. Pursuant to the Note, the Noteholder loaned the Company an aggregate principal amount of $155,548. After the deduction of loan fees of $10,929 the net proceeds from the loan were $144,619. The loan fees are being amortized as original issue discount (OID) over the term of the loan. The interest rate of the loan is 2.25%. The Note requires monthly payments on the Note balance until repaid in full. The maturity date of the Note is December 21, 2035. For the six months ended August 31, 2022, the Company made principal payments of $4,384 and amortized debt discount of $364. The obligations under the Note are secured by a lien on and security interest in the Company's crude oil assets located in Kern County, California, as described in a Deed of Trust entered into by the Company in favor of the Noteholder to secure the obligations under the Note. Such lien shall be a first priority lien, subject only to a pre-existing lien filed by a working interest partner of the Company.

The Company may prepay the Note at any time. Upon the occurrence of any Event of Default and expiration of any applicable cure period, and at any time thereafter during the continuance of such Event of Default, the Noteholder may at its option, by written notice to the Company: (a) declare the entire principal amount of the Note, together with all accrued interest thereon and all other amounts payable hereunder, immediately due and payable; (b) exercise any of its remedies with respect to the collateral set forth in the Deed of Trust; and/or (c) exercise any or all of its other rights, powers or remedies under applicable law.

Current portion of note payable – related party balances at August 31, 2022 and February 28, 2022 are set forth in the table below:

	August 31, 2022	February 28, 2022
Note payable – related party, current portion	$ 8,947	$ 8,829
Unamortized debt issuance expenses	(729)	(729)
Note payable – related party, current portion, net	$ 8,218	$ 8,100

Note payable – related party long-term balances at August 31, 2022 and February 28, 2022 are set forth in the table below:

	August 31, 2022	February 28, 2022
Note payable – related party, non-current	$ 132,207	$ 136,710
Unamortized debt issuance expenses	(8,985)	(9,350)
Note payable – related party, non-current, net	$ 123,222	$ 127,360

Future estimated payments on the outstanding note payable – related party are set forth in the table below:

Twelve month periods ending August 31	
2023	$ 8,946
2024	9,186
2025	9,433
2026	9,686
2027	9,945
Thereafter	93,957
Total	$ 141,153

Short-term Convertible Note Payable

During the twelve months ended February 28, 2022, the Company executed a convertible promissory note with a third party for $200,000. The interest rate was 18% per annum and is payable in kind (PIK) solely by additional shares of the Company's common stock. Regardless of when the conversion occurred, a full 12 months of interest would be payable upon conversion. On May 5, 2022, the Company received notice of conversion of the promissory note. The face amount of the note and $36,000 in interest were converted at a rate of $0.0085 per share into 27,764,706 share of the Company's common stock during the six months ended August 31, 2022.

12% Subordinated Notes

The Company's 12% Subordinated Notes ("the Notes") issued pursuant to a January 2010 private placement offering to accredited investors, resulted in $595,000 in gross proceeds (of which $250,000 was from a related party) to the Company and accrue interest at 12% per annum, payable semi-annually on January 29th and July 29th. On January 29, 2015, the Company and 12 of the 13 holders of the Notes agreed to extend the maturity date of the Notes for an additional two years to January 29, 2017. Effective January 29, 2017, the maturity date of the Notes and the expiration date of the warrants that were issued in conjunction with the Notes were extended for an additional two years to January 29, 2019.

As a result of the Company restructuring its balance sheet through conversions of related party debt to common stock, the related party 12% Noteholder, James F. Westmoreland, the Company's President and Chief Executive Officer, chose to convert the principal and accrued interest of their Notes to the Company's common stock. The related party Note for $250,000 and accrued interest of $264,986 were converted to common stock at a rate of approximately $0.45 for every dollar of principal and interest resulting in 1,144,415 shares of common stock being issued.

During the six months ended August 31, 2022, one 12% Note holder chose to convert the principal balance and accrued interest in to the Company's common stock. The $25,000 Note and accrued interest of $10,520 were converted at a rate of approximately $0.45 for every dollar of principal and interest resulting in 78,934 shares of common stock being issued.

The Company has informed the Note holders that the payment of principal and final interest will be late and is subject to future financing being completed and the Company's cash flow. The Notes principal of $290,000 has not been paid. The terms of the Notes, state that should the Board of Directors decide that the payment of the principal and any unpaid interest would impair the financial condition or operations of the Company, the Company may then elect a mandatory conversion of the unpaid principal and interest into the Company's common stock at a conversion rate equal to 75% of the average closing price of the Company's common stock over the 20 consecutive trading days preceding December 31, 2018. The accrued interest on the 12% Notes at August 31, 2022 and February 28, 2022 was $142,251 and $135,229, respectively.

12% Note balances at August 31, 2022 and February 28, 2022 are set forth in the table below:

	August 31, 2022	February 28, 2022
12% Subordinated Notes	$ 290,000	$ 315,000
12% Subordinated Notes – related party	—	—
Total 12% Subordinated Note balance	$ 290,000	$ 315,000

Line of Credit

The Company had an existing $890,000 line of credit for working capital purposes with UBS Bank USA ("UBS"), established pursuant to a Credit Line Agreement dated October 24, 2011 that was secured by the personal guarantee of its Chairman, President and Chief Executive Officer. On May 26, 2022, the Company paid off the outstanding balance of $809,930 on the line of credit. The payoff of the line of credit was previously approved under terms of the Equity Exchange Agreement in which the Company acquired the Reabold property in California. The payoff was a part of the use of proceeds from the Company's sale of common stock to a third party.

Production Revenue Payable

Beginning in December 2018, the Company conducted a fundraising program to fund the drilling of future wells in California and Michigan and to settle some of its historical debt. The purchaser(s) of a production revenue payment interest received a production revenue payment on future wells to be drilled in California and Michigan in exchange for their purchase. The production payment interest entitles the purchasers to receive production payments equal to twice their original amount paid, payable from a percentage of the Company's future net production payments from wells drilled after the date of the purchase and until the Production Payment Target (as described below) is met. The Company shall pay fifty percent of its net production payments from the relevant wells to the purchasers until each purchaser has received two times the purchase price (the "Production Payment Target"). Once the Company pays the purchasers amounts equal to the Production Payment Target, it shall thereafter pay a pro-rated eight percent (8%) of $1.3 million on its net production payments from the relevant wells to each of the purchasers. However, if the total raised is less than the target $1.3 million, then the payment will be a proportionate amount of the eight percent (8%). Additionally, if the Production Payment Target is not met within the first three years, the Company shall pay seventy-five percent of its production payments from the relevant wells to the purchasers until the Production Payment Target is met.

The Company accounted for the amounts received from these sales in accordance with ASC 470-10-25 and 470-10-35 which require amounts recorded as debt to be amortized under the interest method as described in ASC 835-30, Interest Method. Consequently, the program balance of $885,606 has been recognized as a production revenue payable. The Company determined an effective interest rate based on future expected cash flows to be paid to the holders of the production payment interests. This rate represents the discount rate that equates estimated cash flows with the initial proceeds received from the sales and is used to compute the amount of interest to be recognized each period. Estimating the future cash outflows under this agreement requires the Company to make certain estimates and assumptions about future revenues and payments and such estimates are subject to significant variability. Therefore, the estimates are likely to change which may result in future adjustments to the accretion of the interest expense and the amortized cost based carrying value of the related payables.

Accordingly, the Company has estimated the cash flows associated with the production revenue payments of $984,601 and determined a discount of $98,995 as of August 31, 2022, which is being accounted as interest expense over the estimated period over which payments will be made based on expected future revenue streams. For the six months ended August 31, 2022 and 2021, amortization of the debt discount on these payables amounted to $68,482 and $54,304, respectively, which has been included in interest expense in the statements of operations.

Production revenue payable balances at August 31, 2022 and February 28, 2022 are set forth in the table below:

	August 31, 2022	February 28, 2022
Estimated payments of production revenue payable	$ 984,601	$ 941,259
Less: unamortized discount	(98,994)	(124,134)
	885,607	817,125
Less: current portion	(251,734)	(78,877)
Net production revenue payable – long-term	$ 633,873	$ 738,248

Encumbrances

On October 17, 2018, a working interest partner in California filed a UCC financing statement in regards to payable amounts owed to the partner by the Company.

Operating Leases

The Company leases approximately 988 rentable square feet of office space from an unaffiliated third party for our corporate office located in Spokane Valley, Washington. Additionally, we lease approximately 416 and 695 rentable square feet from unaffiliated third parties for our regional operations office in Friendswood, Texas and storage and auxiliary office space in Wallace, Idaho, respectively. The lease in Friendswood is a 12 month lease that expires in October 2022. The Spokane Valley and Wallace leases are currently on a month-to-month basis. The Company's lease agreements do not contain any residual value guarantees, restrictive covenants or variable lease payments. The Company has not entered into any financing leases.

The Company determines if an arrangement is a lease at inception. Operating leases are recorded in operating lease right of use assets, net, operating lease liability – current, and operating lease liability – long-term on its balance sheet.

Rent expense for the six months ended August 31, 2022 and 2021 was $11,895 and $11,745, respectively.

Related Party Transactions

In California at the East Slopes Project, two of the vendors that the Company uses for services are partially owned by a related party, the Company's Chief Operating Officer. The Company's Chief Operating Officer is a 50% owner in both Great Earth Power and ABPlus Net Holdings. Great Earth Power began providing a portion of the solar power electrical service for production operations in July 2020. ABPlus Net Holdings began providing portable tank rentals to the Company as a part of its water treatment and disposal operations in September 2020. The services provided by Great Earth Power and ABPlus Net Holdings are competitive with other vendors and save the Company significant expense. For the six months ended August 31, 2022 and 2021, Great Earth Power was paid $9,716 and $10,675, respectively. For the six months ended August 31, 2022 and 2021, ABPlus Net holdings was paid $5,760 and $5,760, respectively.

Capital Commitments

Daybreak has ongoing capital commitments to develop certain leases pursuant to their underlying terms. Failure to meet such ongoing commitments may result in the loss of the right to participate in future drilling on certain leases or the loss of the lease itself. These ongoing capital commitments may also cause us to seek additional capital from sources outside of the Company. The current uncertainty in the credit and capital markets, and the current economic downturn in the energy sector, may restrict our ability to obtain needed capital.

Management Plans to Continue as a Going Concern

We continue to implement plans to enhance our ability to continue as a going concern. Daybreak currently has a net revenue interest ("NRI") in 20 producing crude oil wells in its East Slopes Project located in Kern County, California (the "East Slopes Project"). The revenue from these wells has created a steady and reliable source of income for the Company. The Company's average working interest ("WI") in these wells is 36.6% and the average net revenue interest ("NRI") is 27.6% for these same wells.

In May 2022, we acquired Reabold California, LLC ("Reabold") from a third party. This property currently includes four producing wells, five shut-in wells, and two potential disposal wells in the Monterey and Contra Costa counties of California. This project includes four producing wells. We have a 50% working interest with a 40% net revenue interest in this project.

In conjunction with our acquisition of Reabold, we were able to secure a capital raise of $2,500,000 through the issuances of the Company's common stock.

We anticipate our revenue will continue to increase as the Company participates in the drilling of more wells in the East Slopes and the Reabold Projects in California. Daybreak's sources of funds in the past have included the debt or equity markets and the sale of assets. It will be necessary for us to obtain additional funding from the private or public debt or equity markets in the future. However, we cannot offer any assurance that it will be successful in executing the aforementioned plans to continue as a going concern.

Our financial statements as of August 31, 2022 do not include any adjustments that might result from the inability to implement or execute our plans to improve our ability to continue as a going concern.

Critical Accounting Policies

Refer to Daybreak's Annual Report on Form 10-K for the fiscal year ended February 28, 2022.

Off-Balance Sheet Arrangements

As of August 31, 2022, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partners that have been, or are reasonably likely to have, a material effect on our financial position or results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, we are not required to provide the information otherwise required by this Item.

ITEM 4. CONTROLS AND PROCEDURES

Management's Evaluation of Disclosure Controls and Procedures

As of the end of the reporting period, August 31, 2022, an evaluation was conducted by Daybreak management, including our President and Chief Executive Officer, who is also serving as our interim principal finance and accounting officer, as to the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) of the Exchange Act. Such disclosure controls and procedures are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods specified by the SEC rules and forms. Additionally, it is vital that such information is accumulated and communicated to our management, including our President and Chief Executive Officer, in a manner to allow timely decisions regarding required disclosures. Based on that evaluation, our management concluded that our disclosure controls were effective as of August 31, 2022.

Changes in Internal Control over Financial Reporting

During the three months ended August 31, 2022, there have not been any changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Limitations

Our management does not expect that our disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions.

Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this Form 10-Q Report, you should carefully consider the various factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended February 28, 2022, which could materially affect our business, financial condition or future results. Our Annual Report is available from the SEC at www.sec.gov. The risks described in this report are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial could have a material adverse effect on our business, financial condition or future results of operations.

ITEM 6. EXHIBITS

The following Exhibits are filed as part of the report:

Exhibit Number	Description
3.02[(1)]	Second Amended and Restated Articles of Incorporation of Daybreak Oil and Gas, Inc. dated May 20, 2022.
4.02[(1)]	Description of Securities.
31.1[(1)]	Certification of principal executive and principal financial officer as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1[(1)]	Certification of principal executive and principal financial officer as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS[(2)]	Inline XBRL Instance Document
101.SCH[(2)]	Inline XBRL Taxonomy Schema
101.CAL[(2)]	Inline XBRL Taxonomy Calculation Linkbase
101.DEF[(2)]	Inline XBRL Taxonomy Definition Linkbase
101.LAB[(2)]	Inline XBRL Taxonomy Label Linkbase
101.PRE[(2)]	Inline XBRL Taxonomy Presentation Linkbase
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

(1) Filed herewith.
(2) Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DAYBREAK OIL AND GAS, INC.

By:	/s/ JAMES F. WESTMORELAND
	James F. Westmoreland, its President, Chief Executive Officer and interim principal finance and accounting officer (Principal Executive Officer, Principal Financial Officer and Principal Accounting Officer)
Date:	October 27, 2022

Exhibit 31.1

Certification

I, James F. Westmoreland, certify that:

(1) I have reviewed this interim report on Form 10-Q of Daybreak Oil and Gas, Inc.

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

(5) The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: October 27, 2022

By /s/ JAMES F. WESTMORELAND
James F. Westmoreland, President, Chief Executive Officer
and interim principal finance and accounting officer
(Principal Executive Officer, Principal Financial Officer and Principal Accounting Officer)

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Interim Report of Daybreak Oil and Gas, Inc. on Form 10-Q for the period ending August 31, 2022, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, the undersigned, in the capacity and on the date indicated below, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 27, 2022

By /s/ JAMES F. WESTMORELAND
James F. Westmoreland, President, Chief Executive Officer
and interim principal finance and accounting officer
(Principal Executive Officer, Principal Financial Officer and Principal Accounting Officer)

Exhibit 3.01

SECOND AMENDED AND RESTATED ARTICLES OF INCORPORATION OF DAYBREAK OIL AND GAS, INC.

ARTICLE I - NAME

The name of this corporation is DAYBREAK OIL AND GAS, INC. (the "**Corporation**").

ARTICLE II - PURPOSE

The purpose of the Corporation is to transact any and all lawful business for which corporations may be incorporated under Title 23B of the Revised Code of Washington, as amended (the "**Washington Business Corporation Act**").

ARTICLE III – REGISTERED OFFICE AND AGENT

The address of the registered office of the Corporation is 1101 N. Argonne Rd, Suite A 211, Spokane Valley, Washington 99212, and the name of the registered agent at such address is Tina Meland.

ARTICLE IV – DURATION

The duration of the Corporation is perpetual.

ARTICLE V - DIRECTORS

The number of directors constituting the board of directors of the Corporation (the "**Board**") will be fixed in the manner specified in the bylaws of the Corporation (the "**Bylaws**"). In the case of a vacancy in the Board because of a director's resignation, removal or other departure from the Board, or because of an increase in the number of directors, the remaining directors, by majority vote, or the sole remaining director, in each case, although less than a quorum, and not the shareholders, shall fill such vacancy. If for any reason there are no directors in office, the vacancies will be filled by a special election by shareholders.

ARTICLE VI – CAPITAL SHARES

6.1 Classes. The authorized capital stock of the Corporation shall consist of one class of stock, designated as Common Stock.

6.2 Common Stock. The total number of shares of Common Stock that the Corporation will have authority to issue is Five Hundred Million (500,000,000). The shares shall have a par value of $0.001 per share. Each holder of Common Stock shall be entitled to one vote for each share of Common Stock held. All of the Common Stock authorized herein shall have equal voting rights and powers without restrictions in preference.

6.3 Issuance of Certificates. The Board shall have the authority to issue shares of the capital stock of this Corporation and the certificates therefor subject to such transfer restrictions and other limitations as it may deem necessary to promote compliance with applicable federal and state securities laws, and to regulate the transfer thereof in such manner as may be calculated to promote such compliance or to further any other reasonable purpose.

6.4 Required Vote. Where a higher vote is provided by the Washington Business Corporation Act, including votes of a separate voting group where applicable, the required vote shall instead be a majority of all the votes entitled to be cast on the matter being voted on and, where applicable, of each other voting group entitled to vote separately on the matter.

ARTICLE VII - BYLAWS

In furtherance and not in limitation of the powers conferred by statute, the Board is expressly authorized to make, adopt, repeal, alter, amend, and rescind the Bylaws by a resolution adopted by a majority of the directors.

ARTICLE VIII – NO CUMULATIVE VOTING

Shareholders of the Corporation do not have the right to cumulate votes in the election of directors.

ARTICLE IX – NO PREEMPTIVE RIGHTS

Shareholders of the Corporation have no preemptive rights to acquire additional shares issued by the Corporation, or any securities convertible into, or carrying or evidencing any rights or option to purchase, any such shares, *other than* any preemptive rights otherwise described within these Articles.

ARTICLE X – LIMITATION OF DIRECTOR LIABILITY; INDEMNIFICATION

A director of the Corporation will not be personally liable to the Corporation or its shareholders for monetary damages for conduct as a director, except for liability of the director for (i) acts or omissions that involve intentional misconduct or a knowing violation of law by the director; (ii) conduct which violates Section 23B.08.310 of the Washington Business Corporation Act, pertaining to unpermitted distributions to shareholders or loans to directors; or (iii) any transaction from which the director will personally receive a benefit in money, property, or services to which the director is not legally entitled. If the Washington Business Corporation Act is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation will be eliminated or limited to the fullest extent permitted by the Washington Business Corporation Act, as so amended. Any repeal or modification of the foregoing paragraph by the shareholders of the Corporation will not adversely affect any right or protection of a director of the Corporation for or with respect to any acts or omissions occurring prior to such repeal or modification.

The Corporation is authorized to indemnify, agree to indemnify or obligate itself to advance or reimburse expenses incurred by its Directors, officers, employees or agents in any Proceeding (as defined in the Washington Business Corporation Act) to the fullest extent permitted under the laws of the State of Washington, as may now or hereafter exist.

[signature page follows]

SIGNATURE PAGE TO

SECOND AMENDED AND RESTATED ARTICLES OF

INCORPORATION OF

DAYBREAK OIL AND GAS, INC.

The undersigned duly authorized corporate officer of Daybreak Oil and Gas, Inc. certifies that the above is a true and correct copy of the duly adopted and authorized Second Amended and Restated Articles of Incorporation of Daybreak Oil and Gas, Inc., as of the date referenced below.

Signed on May 20, 2022.

/s/ JAMES F. WESTMORELAND
James F. Westmoreland
President and Chief Executive Officer

EXHIBIT 4.01

DESCRIPTION OF SECURITIES

Under our Second Amended and Restated Articles of Incorporation, the Company is authorized to issue up to 500,000,000 shares of common stock, par value $0.001 per share. As of August 31, 2022, there were 384,735,402 shares of our Common Stock issued and outstanding.

Each holder of common stock shall be entitled to one vote for each share of common stock held. All of the common stock authorized herein shall have equal voting rights and powers without restrictions in preference. Shareholders of the Corporation do not have the right to cumulate votes in the election of directors.

The Company's common stock is the Company's only class of outstanding securities registered under Section 12 of the Securities Exchange Act of 1934, as amended. Our common stock is quoted on the OTC Pink® Open Market under the symbol DBRM.

This summary is not complete, and is subject to and qualified by the provisions of our Second Amended and Restated Articles of Incorporation and our Amended and Restated Bylaws. The terms of our common stock are also subject to and qualified by the applicable provisions of the Washington Business Corporation Act.

The holders of shares of common stock vote together as one class on all matters as to which common stockholders are entitled to vote. Each share of common stock is entitled to one vote in all elections of directors and on all other matters submitted to a stockholder vote. We have not declared any cash dividends on our common stock and we do not anticipate paying any cash dividends on our common stock in the foreseeable future. In the event of our liquidation, dissolution or winding up, holders of the common stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior liquidation rights of preferred stock, if any, then outstanding. The common stock has no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to the common stock. The common stock currently outstanding is fully paid and nonassessable.

Anti-Takeover Effects of our Charter and Bylaws

Certain provisions of our Second Amended and Restated Articles of Incorporation and Amended and Restated Bylaws could have the effect of delaying, deterring or preventing another party from acquiring or seeking to acquire control of the Company. For example, our Second Amended and Restated Articles of Incorporation and Amended and Restated Bylaws include provisions that:

- provide that, except as provided by law, special meetings of shareholders of the Corporation shall be held whenever called by (only) the Board of Directors, and;
- establish advance notice procedures with respect to stockholder proposals and the nomination of candidates for election as directors.