

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-KSB/A
AMENDMENT NO. 2

(Mark One)

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

For the fiscal year ended February 29, 2008

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

For the transition period _____ to _____

Commission file number 000-50107

DAYBREAK OIL AND GAS, INC.

(Name of small business issuer in its charter)

Washington

(State or other jurisdiction of incorporation or organization)

91-0626366

(I.R.S. Employer Identification No.)

601 W. Main Ave., Suite 1012, Spokane, WA

(Address of principal executive offices)

99201

(Zip code)

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

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: Common Stock, par value \$0.001 per share

Check whether issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The registrant's revenues for its most recent fiscal year were \$1,017,604.

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, based on the closing price of \$0.45 on May 20, 2008, as reported by the Over the Counter Bulletin Board was \$20,054,834.

At May 20, 2008, the registrant had 44,566,299 outstanding shares of \$0.001 par value common stock.

Documents Incorporated by Reference:

Part III of the Form 10-KSB incorporates by reference certain portions of the registrant's proxy statement for its 2008 annual meeting of shareholders to be filed with the Commission not later than 120 days after the end of the fiscal year covered by this report.

Transitional Small Business Disclosure Format (Check one): Yes No

EXPLANATORY NOTE

Daybreak Oil and Gas, Inc. (the "Company" or "Daybreak") is filing this Amendment No. 2 on Form 10-KSB/A ("Amendment No.2") to amend our Annual Report on Form 10-KSB for the year ended February 29, 2008 which was originally filed with the Securities and Exchange Commission (the "SEC") on May 27, 2008 as amended by Amendment No. 1 on Form 10-KSB/A ("Amendment No. 1") filed with the SEC on July 14, 2008 (together, the "Original Filing").

The purpose of this Amendment No. 2 is to respond to comments received from the SEC's Division of Corporation Finance by clarifying certain items in the Original Filing, and restating the Company's financial statements, and to make certain other corrections to our prior disclosure, as detailed below. In response to comments and a review by the SEC, the Company determined that it should follow the guidance of Statement of Financial Accounting Standards No. 123R ("FAS 123R") Share-Based Payment and FSP EITF 00-19-2 Accounting for Registration Payment Arrangements in its accounting treatment of warrants offered by the Company in February 2008 to participants of the two private placement offerings that occurred in 2006 (the "Warrants"). The financial statements are being restated to recognize a non-cash expense for the recordable valuation of the Warrants in accordance with FAS 123R.

This Amendment No. 2 amends the following: (i) Part I Item 1, Description of Business, Risk Factors; (ii) Part I, Item 2, Description of Properties; (iii) Part II, Item 5, Market for Common Equity, Related Stockholder Matters and Small Business Issuer Purchase of Equity Securities, to revise discussion of goodwill warrants issued to private placement participants; (iv) Part II, Item 6, Management's Discussion and Analysis or Plan of Operation, to revise discussion of financial results based on the restated financial statements; (v) Part II, Item 7, Financial Information, all Financial Statements; to (a) restate the financial statements as discussed above, and correct the Net Loss Per Common Share from continuing operations on the Statement of Operations for the comparative fiscal year which was reported as a greater loss per share than actually occurred, (b) amend Note 2, Summary of Significant Accounting Policies – Concentration of Credit Risk, (c) Note 11, Warrants, to correct reporting errors in the warrant table, which resulted in the inadvertent reporting of incorrect data regarding the number of exercisable warrants remaining but had no effect on any financial data reported in the Original Filing; (d) Note 12, Income Taxes, to report revised calculations based on the restated financial statements; (e) add a new Note 14, Restatement, (f) amend the Supplementary Information for Oil and Gas Producing Activities; (vi) Item 8A, Controls and Procedures, (vii) Item 13, Exhibits, to include (a) a copy of the Consent of the Company's independent engineering firm, included as Exhibit 23.2; and (b) new certifications by our principal executive and principal financial officer, included as Exhibits 31.1 and 32.1.

Pursuant to Rule 12b-15 under the Securities Exchange Act of 1934, as amended, this Amendment No. 2 amends these Items 2, 7, 8A and 13 in their entirety.

This Amendment No. 2 continues to reflect the financial position of the Company as of the date of the original filing and, except as disclosed in this Explanatory Note, we have not updated the disclosure contained herein to reflect events that have occurred since the date of the Original Filing.

Pursuant to Rule 12b-15 under the Securities Exchange Act of 1934, as amended, this Amendment No. 2 contains new certifications of our Chief Executive Officer and Chief Financial Officer. All other exhibits as filed in our Form 10-KSB filed on May 27, 2008 are hereby incorporated by reference. This amendment does not reflect events occurring after the filing of the Original Form 10-KSB, and does not modify or update the disclosures therein in any way other than as required to reflect the matters described above. Accordingly, this Amendment No. 2 should be read in conjunction with our other filings made with the Securities and Exchange Commission.

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CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

We believe that some statements contained in this 10-KSB annual report relate to results or developments that we anticipate will or may occur in the future and 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 statements about the following:

- Our future operating results,
- Our future capital expenditures,
- Our expansion and growth of operations, and
- Our future investments in and acquisitions of oil and natural gas 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. Factors that might cause such a difference include:

- General economic and business conditions,
- Exposure to market risks in our financial instruments,
- Fluctuations in worldwide prices and demand for oil and natural gas,
- Fluctuations in the levels of our oil and natural gas exploration and development activities,
- Risks associated with oil and natural gas exploration and development activities,
- Competition for raw materials and customers in the oil and natural gas industry,
- Technological changes and developments in the oil and natural gas industry,
- Regulatory uncertainties and potential environmental liabilities,
- Additional matters discussed under “Risk Factors.”

PART I

ITEM 1. DESCRIPTION OF BUSINESS

Background

Daybreak Oil and Gas, Inc. (referred to herein as “we,” “our,” “Daybreak” or the “Company”) was originally incorporated in the State of Washington on March 11, 1955 as Daybreak Uranium, Inc. The Company was established for the purpose of mineral exploration and development on claims or leased lands throughout the western United States. In August 1955, we acquired the assets of Morning Sun Uranium, Inc. By the late 1950s, the Company had ceased to be a producing mining company and thereafter engaged in mineral exploration. In May 1964, to reflect the diversity of its mineral holdings, the Company changed its name to Daybreak Mines, Inc. The trading symbol for the Company became DBRM.

Our subsequent efforts in the acquisition, exploration and development of potentially viable commercial properties were unsuccessful. By February 1967, we had ceased active operations. After that time, our activities were confined to annual assessment and maintenance work on our Idaho mineral properties and other general and administrative functions. In November 2004, we sold our mineral rights in approximately 340 acres in Shoshone County, Idaho.

Oil and Gas Overview

Effective March 1, 2005, we undertook a new business direction for the Company; that of an exploration and development company in the oil and gas industry. We have become an early stage oil and gas exploration and development company with projects in Alabama, California Louisiana and Texas. In October of 2005, to better reflect this new direction of the Company, our shareholders approved changing our name to Daybreak Oil and Gas, Inc. Our common stock is quoted on the OTC Bulletin Board (OTC.BB) market under the symbol DBRM.OB.

We are actively pursuing oil and gas opportunities through joint ventures with industry partners as a means of limiting our drilling risk. Our prospects are generally brought to us by other oil and gas companies or individuals. We identify and evaluate prospective oil and gas properties to determine both the degree of risk and the commercial potential of the project. We are currently developing projects that offer a mix of low risk with a potential of steady reliable revenue as well as projects with a higher risk, but that may also have a larger return. We strive to use modern 3-D (three dimensional) seismic technology to help us identify potential drilling targets and to minimize our risk. We seek to maximize the value of our asset base by exploring and developing properties that have both production and reserve growth potential. We seek out other industry partners to maintain a balanced working interest in all of our projects. We also seek acquisitions that will complement our exploration portfolio.

In many instances, we strive to be operator of our oil and gas properties. As the operator, we are more directly in control of the costs of drilling, completion and production operations on our projects. Additionally, operatorship increases the expertise of Daybreak personnel in significant oil and gas operations including lease negotiations, governmental reporting, permitting, drilling, completion, production operations and marketing.

Historical Business Development

Effective March 1, 2005, we undertook a new business direction for the Company, that of an exploration and development company in the oil and gas industry. We have become an early stage exploration and development company with projects in Alabama, California, Louisiana and Texas.

Between March 22, 2005 and August 31, 2005, we borrowed a total of \$168,821 from six officers, directors or shareholders to fund operating capital needs.

In April of 2005, we signed two oil and gas exploration and development agreements for exploration projects located in Texas (Ginny South and Pearl Projects).

From June through December 2005, we conducted a private placement of our common stock. The proceeds were used to pay for lease, exploration and drilling expenses of the Company as well as working capital. Net proceeds to the Company were \$1,087,500.

In July 2005, we entered into an exploration agreement with an industry partner and three Geotechnical professionals to jointly develop an AMI (Area of Mutual Interest) located in the San Joaquin Basin of California (East Slopes Project).

In September 2005, we entered into an exploration agreement to jointly develop an AMI located in northeast Louisiana (Tuscaloosa Project).

In November 2005, we agreed to participate in a five well re-entry program in the Saxet Deep Field in Corpus Christi, Texas.

In December 2005, we borrowed \$60,000 to help finance exploration activities as well as increase operating capital. Additionally, we drilled our first well (Ginny South) in San Patricio County, Texas. The well was unsuccessful and consequently plugged and abandoned.

In January 2006, we drilled our second well, the Tensas Farms et al "F-1" location on the Tuscaloosa Project in NE Louisiana. The well was completed and placed into commercial production in June of 2006. The well was shut-in due to technical issues with water production in November 2006. Additionally on January 13, 2006, a seventh director was appointed to the Board of Directors. This individual was Terrence J. Dunne, a shareholder and 10% control person at the time.

Between January 25, 2006 and February 8, 2006, we borrowed a total of \$806,700 from seven shareholders to help finance exploration activities as well as increase operating capital.

Between February 24, 2006 and March 6, 2006, we borrowed \$325,001 from four shareholders to meet operating capital needs.

On March 8, 2006, we and our working interest partners purchased a 50% interest in the mineral rights for 28,000 acres that were located within the original AMI of the Tuscaloosa Project located in NE Louisiana.

From March through May 2006, we conducted a private placement of our common stock that raised net proceeds of \$5,188,257 for use in acquiring leases, funding our drilling program and meeting our working capital needs.

On March 30, 2006, we agreed to jointly participate in an exploration project at the Krotz Springs Field located in St. Landry Parish, Louisiana.

In May 2006, we started the first re-entry of five wells in the Saxet Deep Field near the Corpus Christi, Texas airport. We also agreed to jointly participate in exploration projects located in St. Landry Parish, Louisiana (North Shuteston) and in Alberta, Canada (40 Mile Coulee). In an effort to conserve cash flow, we financed our 40% ownership in the pipeline that is connected to the "F-1" well on the Tuscaloosa Project in NE Louisiana.

In July 2006, we conducted a private placement of our preferred stock that raised net proceeds of \$3,626,204 for use in acquiring leases, funding our drilling program and meeting working capital needs.

In August 2006, we finalized an agreement for the refurbishment of a drilling rig. Daybreak had the right to exclusive use of the drilling rig for a three-year period. From August through November 2006, we advanced \$800,000 for the refurbishment of the rig. In May 2007, the drilling rig was sold and the note receivable plus interest was paid off. Additionally on August 3rd, Eric L. Moe was appointed as the eighth member of the Board of Directors and to the position of Chief Executive Officer.

In December 2006, we agreed to jointly participate in an oilfield re-entry project in East Gilbertown Field located in Choctaw County, Alabama. Additionally, we drilled two more exploratory wells as part of the Tuscaloosa Project located in Tensas and Franklin Parishes, Louisiana. The "F-3" well (Tensas Parish) was completed and placed into commercial production in February 2007. From late July through November 2007 the well was shut-in or produced only sporadically due to downstream gas sales issues. In November 2007, the F-3 was shut in pending installation of mechanical lifting equipment and is expected to return to production in the second quarter of 2008. The "B-1" well (Franklin Parish) was drilled and tested, but was not commercially productive. Further evaluation of this well is pending.

In January 2007, we commenced drilling the Haas-Hirsch No. 1 well located in the East Krotz Springs Field, St. Landry Parish, Louisiana. This well was completed and was placed into commercial production in May 2007. Additionally in January, a ninth director was appointed to the Board of Directors. This individual was Timothy R. Lindsey, who has over thirty years experience in global oil and gas exploration, production, technology and business development.

In May 2007, we commenced procedures to attempt to resolve the technical production problems associated with the Tuscaloosa "F-1" well. Our efforts resulted in the successful re-establishment of production from this well in mid-July 2007. However, as a result of downstream gas sales issues covering both the F-1 and F-3 wells in the Tuscaloosa Project, these two wells were shut in beginning in late July 2007 through November 2007. The wells were allowed to sporadically produce throughout this time period, but as a result of the well production continually being interrupted, the wells now require the use of mechanical lifting equipment to continue commercial production. The "F-1" returned to full-time commercial production in January 2008. It is anticipated the F-3 well will return to production in the second quarter of 2008.

In September 2007, we commenced drilling operations on the Tensas Farms et al A-1 well in the Tuscaloosa project in Louisiana. The well was successfully completed and commenced production in December 2007. The well achieved “payout” status (recovery of all drilling and completion costs) in March 2008.

From October 2007 through December 2007, a high resolution 3-D seismic survey program was conducted on the portion of our California properties that are a part of the Chevron seismic farm-in area. The seismic will be used to determine four initial drilling prospects in which Daybreak will have a 50% working interest and a 25% revenue interest before royalties to leaseholders.

In December 2007, we drilled and completed the Tensas Farms et al F-2 well, also in the Tuscaloosa project. Further evaluation of this well is pending.

On December 14, 2007, we underwent a change in the management of Daybreak. Robert N. Martin, President resigned from that position and was appointed Senior Vice-President, Exploration; Chief Executive Officer Eric L. Moe resigned from the Company; Timothy R. Lindsey formerly an outside director was appointed interim President and Chief Executive Officer; Chief Financial Officer Terrence J. Dunne resigned from the Company; and Controller Thomas C. Kilbourne resigned from that position but continued as an employee of Daybreak. James F. Westmoreland, formerly a finance and accounting consultant to Daybreak, was appointed interim Chief Financial Officer.

On December 18, 2007, the Board of Directors voted to reduce the number of Board positions to three. Subsequently, the following individuals resigned their positions and offices with the Board of Directors of Daybreak; Robert N. Martin, Eric L. Moe, Terrence J. Dunne, Jeffrey R. Dworkin, Thomas C. Kilbourne and Michael Curtis. Karol L. Adams, formerly a consultant to Daybreak, was appointed Corporate Secretary.

On January 18, 2008, we signed a purchase and sale agreement (“PSA”) with an undisclosed buyer for the sale of our Tuscaloosa project interests for \$8 million in cash. The transaction closed in three tranches; the first closing for \$2 million occurred on January 18, 2008; the second closing for \$500,000 occurred on April 30, 2008; and the final closing for \$5.5 million occurred on June 12, 2008 and was subject to customary closing adjustments. The sale includes Daybreak's interests in the Tensas Farms et al F-1, F-3, B-1, A-1 and F-2 wells; and all of its acreage and infrastructure in the project area. Under terms of the PSA, the effective date for each closing was January 1, 2008.

On March 24, 2008 James F. Meara was appointed to our Board of Directors, thereby expanding the Company's Board to four members.

On April 3, 2008, James F. Westmoreland, formerly interim Chief Financial Officer, was appointed Executive Vice President and Chief Financial Officer; Karol L. Adams was appointed Chief Compliance Officer in addition to the Corporate Secretary duties; Thomas C. Kilbourne was appointed Controller and Assistant Secretary; and Daybreak adopted a series of corporate responsibility statements and employee guidelines.

Competition

We compete with independent oil and gas companies for exploration prospects, property acquisitions and for the equipment and labor required to operate and develop these properties. Many of our competitors have substantially greater financial and other resources than we have. These competitors may be able to pay more for exploratory prospects and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects than we can. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in "Risk Factors" beginning on page 10 of this 10-KSB annual report.

Significant Customers

At each of our property locations in Alabama, Louisiana and Texas, we have oil and gas sales contracts with one dominant purchaser in each respective area. Due to the scarcity of distribution pipelines or sole distributors, we do not have many options for choosing to whom we will sell our oil and gas. If these purchasers are unable to resell their products or if they lose a significant sales contract then we may incur difficulties in selling our oil and gas.

Title to Properties

As is customary in the oil and natural gas industry, we make only a cursory review of title to undeveloped oil and natural gas leases at the time we acquire them. However, before drilling commences, we search the title, and remedy most material defects before we actually begin drilling the well. To the extent title opinions or other investigations reflect title defects, we (rather than the seller or lessor of the undeveloped property) typically are obligated to cure any such title defects at our expense. If we are unable to remedy or cure any title defects so that it would not be prudent for us to commence drilling operations on the property, we could suffer a loss of our entire investment in the property. We believe that we have good title to our oil and natural gas properties, some of which are subject to immaterial encumbrances, easements, and restrictions.

Long Term Success

Our success depends on the successful acquisition, exploration and development of commercial grade oil and gas properties as well as the prevailing prices for oil and natural gas to generate future revenues and operating cash flow. Oil and natural gas prices have been extremely volatile in recent years and are affected by many factors outside our control. This volatile nature of the energy markets makes it difficult to estimate future prices of oil and natural gas; however, any prolonged period of depressed prices would have a material adverse effect on our results of operations and financial condition. Such pricing factors are largely beyond our control, and may result in fluctuations in our earnings. We believe there are significant opportunities available to us in the oil and gas exploration and development industry.

Regulation

The exploration and development of oil and gas properties are subject to various types of federal, state and local laws and regulations. These laws and regulations govern a wide range of matters, including the drilling and spacing of wells, allowable rates of production, restoration of surface areas, plugging and abandonment of wells and specific requirements for the operation of wells.

Laws and regulations relating to our business frequently change, and future laws and regulations, including changes to existing laws and regulations, could adversely affect our business.

RISK FACTORS

The following risk factors together with other information set forth in this Form 10-KSB, should be carefully considered by current and future investors in our securities. An investment in our securities involves substantial risks. If any of the following risks actually occur, our financial condition and our results of operations could be materially and adversely affected. Additional risks and uncertainties not presently known to us may also impair our business operations. In any such case, the trading price of our common stock could decline, and you could lose all, or a part, of your investment.

Risks related to investment in our Company

We have experienced significant operating losses in the past and there can be no assurance that we will become profitable in the future even with the sale of our Tuscaloosa property

The Company reported a net loss of \$5,596,617 for the fiscal year ended February 29, 2008, and a cumulative net loss from inception through February 29, 2008 of \$22,815,299. While we do have enough cash to operate an extensive exploration and drilling program over the next twelve months, without successful exploration and development of properties your investment in the Company could become devalued or worthless.

We are an early stage oil and gas exploration company with a limited operating history on which to base an investment decision

We have a limited history of oil and gas production and have minimal proven reserves. To date, we have had limited revenues and have not yet generated a sustainable positive cash flow or earnings. The Company cannot provide any assurances that we will ever operate profitability. As a result of our limited operating history, we are more susceptible to business risks. These risks include unforeseen capital requirements, failure to establish business relationships, and competitive disadvantages against larger and more established companies.

The resale of shares offered in private placements could depress the value of the shares

Shares of the Company's Common Stock have been offered and sold in private placements at significant discounts to the trading price of the common stock at the time of the offering. Sales of substantial amounts of common stock eligible for future sale in the public market, or the availability of shares for sale, including shares issued upon exercise of outstanding warrants, could adversely affect the prevailing market price of our common stock and our ability to raise capital by an offering of equity securities.

We have paid our officers and directors significant amounts in the form of salaries, consulting fees, and stock which could have an adverse affect on our net operating results and earnings per share

For the fiscal year ended February 29, 2008, we paid our officers and directors a total of \$600,000 in cash for services.

For the fiscal year ended February 28, 2007, we paid our officers and directors a total of \$553,941 in cash for services. During this same period, we granted these individuals 1,050,000 shares of unregistered common stock with a fair value of \$2,206,500 at the grant date for services.

For the fiscal year ended February 28, 2006, we paid our officers and directors a total of \$60,050 in cash for services. During this same period, we granted these individuals 2,783,000 shares of unregistered common stock with a fair value of \$2,010,730 at the grant date for services.

These payments were all approved by the Board of Directors. All compensation payments are accounted for as administrative expenses. These compensation payments have had, and may continue to have, an adverse impact on our net results from operations, and earnings (or losses) per share.

We are an exploration stage company implementing a new business plan making it difficult to evaluate our chance for success

We are an exploration stage company with a limited operating history upon which to base an evaluation of our current business and future prospects. We started in the oil and gas exploration and development industry in March 2005. We are in the early stages of the implementation of our business plan. Based on this limited history, investors do not have a proven basis upon which to determine the probability of our business success.

The oil and gas business is highly competitive placing us at an operating disadvantage

We expect to be at a competitive disadvantage in (a) seeking to acquire suitable oil and or gas drilling prospects; (b) undertaking exploration and development; and (c) seeking additional financing. We base our preliminary decisions regarding the acquisition of oil and or gas prospects and undertaking of drilling ventures upon general and inferred geology and economic assumptions. This public information is also available to our competitors.

In addition, we compete with large oil and gas companies with longer operating histories and greater financial resources than us. These larger competitors, by reason of their size and greater financial strength, can more easily:

- access capital markets;
- recruit more qualified personnel;
- absorb the burden of any changes in laws and regulation in applicable jurisdictions;
- handle longer periods of reduced prices of gas and oil;
- acquire and evaluate larger volumes of critical information;
- compete for industry-offered business ventures.

These disadvantages could create negative results for our business plan and future operations.

We cannot guarantee financial results, making it more difficult to raise additional capital

Since our inception, we have suffered recurring losses from start-up operations and have depended on external financing to sustain our operations. During the year ended February 29, 2008, we reported a net loss of \$5.6 million. If exploration efforts are unsuccessful in establishing proved reserves and exploration activities cease, the amounts accumulated as unproved costs will be charged against earnings as impairments. Potential investors may be dissuaded from investing in the Company based on historical results.

Our ability to reach and maintain profitable operating results is dependant on our ability to find, acquire, and develop oil and gas properties

Our future performance depends upon our ability to find, acquire, and develop oil and gas reserves that are economically recoverable. Without successful exploration and acquisition activities, we will not be able to develop reserves or generate production revenues to achieve and maintain profitable operating results. No assurance can be given that we will be able to find, acquire or develop these reserves on acceptable terms. We also cannot assure that commercial quantities of oil and gas deposits will be discovered that are sufficient to enable us to recover our exploration and development costs. Although certain management personnel have significant experience in the oil and gas industry, we have not yet established a history of locating and developing properties that have economically feasible oil and gas reserves.

To execute our business plan we will need to develop current projects and expand our operations requiring significant capital expenditures which we may be unable to fund

We have a history of net losses and expect that our operating expenses will continue over the next 12 months as we continue to implement our business plan. Our business plan contemplates the development of our current exploration projects and the expansion of our business by identifying, acquiring, and developing additional oil and gas properties.

We need to rely on external sources of financing to meet the capital requirements associated with the development of our current properties and the expansion of our oil and gas operations. We plan to obtain the funding we need through debt and equity markets, as well as property dispositions. There is no assurance that we will be able to obtain additional funding when it is required or that it will be available to us on commercially acceptable terms.

We also intend to make offers to acquire oil and gas properties in the ordinary course of our business. If these offers are accepted, our capital needs will increase substantially. If we fail to obtain the funding that we need when it is required, we may have to forego or delay potentially valuable opportunities to acquire new oil and gas properties. In addition, without the necessary funding, we may default on existing funding commitments to third parties and forfeit or dilute our rights in existing oil and gas property interests.

When we make the determination to invest in oil or gas properties we rely upon geological and engineering estimates which involve a high level of uncertainty

Geologic and engineering data are used to determine the probability that a reservoir of oil or natural gas exists at a particular location. This data is also used to determine whether oil and natural gas are recoverable from a reservoir. Recoverability is ultimately subject to the accuracy of data including, but not limited to, geological characteristics of the reservoir, structure, reservoir fluid properties, the size and boundaries of the drainage area, reservoir pressure, and the anticipated rate of pressure depletion. Also the increasing costs of production operations may render some deposits uneconomic to extract.

The evaluation of these and other factors is based upon available seismic data, computer modeling, well tests and information obtained from production of oil and natural gas from adjacent or similar properties. There is a high degree of risk in proving existence and recoverability of reserves and actual recoveries of proved reserves can differ materially from original estimates. Accordingly, reserve estimates may be subject to downward adjustment. Actual production, revenue and expenditures will likely vary from estimates, and such variances may be material.

Our financial condition will deteriorate if we are unable to retain our interests in our leased oil and gas properties

All of our properties are held under interests in oil and gas mineral leases. If we fail to meet the specific requirements of each lease, the lease may be terminated or otherwise expire. We cannot be assured that we will be able to meet our obligations under each lease. The termination or expiration of our “working interests” (interests created by the execution of an oil and gas lease) relating to these leases would impair our financial condition and results of operations.

We will need significant additional funds to meet capital calls, drilling and other production costs in our effort to explore, produce, develop and sell the natural gas and oil produced by our leases. We may not be able to obtain any such additional funds on acceptable terms.

Title deficiencies could render our oil and gas leases worthless; thus damaging the financial condition of our business

The existence of a material title deficiency can render a lease worthless, resulting in a large expense to our business. We rely upon the judgment of oil and gas lease brokers who perform the field work and examine records in the appropriate governmental office before attempting to place under lease a specific mineral interest. This is a customary practice in the oil and gas industry.

We anticipate that we, or the person or company acting as “operator” (the individual or company responsible for the exploration, exploitation and production of an oil or natural gas well or lease, usually pursuant to the terms of a joint operating agreement among the various parties owning the working interest in the well) on the properties that we lease, will examine title prior to any well being drilled. Even after taking these precautions, deficiencies in the marketability of the title to the leases may still arise. Such deficiencies may render some leases worthless, negatively impacting the financial condition of the Company.

Reliance on certain third party vendors for outsourced services could be detrimental to our business plan

To maximize the use of our otherwise limited capital and human resources, we rely on third party vendors for outsourced drilling, exploration and other operational services. This practice could allow us to achieve cost savings and operational efficiencies. However, the use of outsourced resources could expose us to greater risk should we be unable to source critical vendors on a cost budgeted and timely basis.

Furthermore, the use of outsourced resources could minimize our ability to control the work product and accountability of such vendors. If any of these relationships with third-party service providers are terminated or are unavailable on commercially acceptable terms, our business plan will be adversely affected.

If we as operators, or our operators of our oil and gas projects fail to maintain adequate insurance, our business could be exposed to significant losses

Our oil and gas projects are subject to risks inherent in the oil and gas industry. These risks involve explosions, uncontrollable flows of oil, gas or well fluids, pollution, fires, earthquakes and other environmental issues. These risks could result in substantial losses due to injury and loss of life, severe damage to and destruction of property and equipment, pollution and other environmental damage. As protection against these operating hazards we maintain insurance coverage to include physical damage and comprehensive general liability. However, we are not fully insured in all aspects of our business. For projects in which we function as the operator, the occurrence of a significant event against which we are not adequately covered by insurance could have a material adverse effect on our financial position.

In the projects in which we are not the operator, we require the operator to maintain insurance of various types to cover our operations with policy limits and retention liability customary in the industry. The occurrence of a significant adverse event on any of these projects if they are not fully covered by insurance could result in the loss of all or part of our investment. The loss of this project investment could have a material adverse effect on our financial condition and results of operations.

We have limited control over the activities on properties we do not operate, which could reduce or negate the expected returns on these investments

We currently conduct our oil and gas exploration and development activities in joint ventures with other industry partners. We have reserved the right to participate in management decisions through operating agreements with our partners, but do not have ultimate decision-making authority.

In many cases, success in the operation of our properties will be dependent on the expertise and financial resources of our joint venture partners and third-party operators. Our dependence on the operator and other working interest owners resulting in our limited ability to control the operation could adversely affect the realization of our expected returns and lead to unexpected future costs.

We are not in control of our own oil and gas distribution systems and are therefore dependent on the sales contracts of oil and gas resellers to provide a market for us, which could result in our not being able to produce from our wells

In each of our producing properties, there is only one market available to purchase our oil and gas production. If that reseller were to lose a significant sales contract or customer then we might not be able to produce an otherwise productive well because of a lack of a market in which to sell oil or gas. Additionally, we are subject to the traditional seasonal energy demands that exist in the oil and gas industry.

We may lose key management personnel which could endanger the future success of our oil and gas operations

Our Interim President and Chief Executive Officer, our Chief Financial Officer, our Senior Vice-President, Exploration and one director have substantial experience in the oil and gas business. The balance of the management team has limited experience in managing or conducting oil and gas operations. The loss of any of these individuals, particularly our Interim President and Chief Executive Officer or our Chief Financial Officer could adversely affect our business. If one or more members of our management team dies, becomes disabled or voluntarily terminates employment with us, there is no assurance that a suitable or comparable substitute will be found.

We have disclosed material weakness in our disclosure controls and procedures which could erode investor confidence, jeopardize our ability to obtain insurance and limit our ability to attract qualified persons to serve the Company

In our fiscal 2007 and 2008 annual and quarterly SEC filings, we disclosed material weaknesses in our disclosure controls and procedures. Predicated by the identification of these weaknesses, we have carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures.

We have evaluated our internal controls over financial reporting and based upon those evaluations, concluded that our disclosure controls and procedures were in need of improvement and were not effective to ensure timely reporting under the Exchange Act. We are working to correct this situation as quickly and effectively as possible with new processes and controls.

We are required to evaluate our internal controls under Section 404 of the Sarbanes-Oxley Act of 2002 ("SOX"), and any adverse results from such evaluation could result in a loss of investor confidence in our financial reports and have an adverse effect on the price of our shares of common stock.

Pursuant to Section 404 of SOX, beginning with this annual report on Form 10-KSB for the fiscal year ended February 29, 2008, we are required to furnish a report by management on our internal controls over financial reporting. This report contains among other matters, an assessment of the effectiveness of our internal control over financial reporting, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by our management.

During the evaluation and testing process, we did identify one or more material weaknesses in our internal control over financial reporting, and are therefore unable to assert that such internal control is effective. Since we are unable to assert that our internal control over financial reporting is effective (or if our auditors are unable to attest in the future that our management's report is fairly stated or they are unable in the future to express an opinion on the effectiveness of our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which could have a material adverse effect on our stock price.

Failure to comply with these rules may make it more difficult for us to obtain certain types of insurance, including director and officer liability insurance. We may be forced to accept reduced policy limits and coverage and/or incur substantially higher costs to obtain the same or similar coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our Board of Directors, on committees of our Board of Directors, or as executive officers.

The market price of our common stock could be volatile, which may cause the investment value of our stock to decline

Our common stock is quoted on the OTC Bulletin Board (OTC.BB) market under the symbol DBRM.OB. From July 2, 2007 to December 13, 2007, our stock was quoted in the OTC pink sheet market, due to SEC filing delinquencies. Having satisfied financial filing compliance standards, we returned to being quoted on the OTC Bulletin Board market after the filing of our second fiscal quarter 2008 10-QSB report.

The Bulletin Board market is characterized by low trading volume. Because of this limited liquidity, shareholders may be unable to sell their shares at or above the cost of their purchase prices. The trading price of our shares has experienced wide fluctuations and these shares may be subject to similar fluctuations in the future.

The trading price of our common stock may be affected by a number of factors including events described in the risk factors set forth in this 10-KSB report, as well as our operating results, financial condition, announcements of drilling activities, general conditions in the oil and gas exploration and development industry, and other events or factors.

In recent years, broad stock market indices, in general, and smaller capitalization companies, in particular, have experienced substantial price fluctuations. In a volatile market, we may experience wide fluctuations in the market price of our common stock. These fluctuations may have a negative effect on the market price of our common stock.

Privately placed issuances of our common stock have and may continue to dilute ownership interests which could have an adverse effect on our stock prices

Our authorized capital stock consists of 200,000,000 shares of common stock and 10,000,000 shares of preferred stock. As of February 29, 2008, there were 44,293,299 shares of common stock and 1,297,465 shares of Series A Convertible Preferred stock issued and outstanding.

As of February 29, 2008, the Company had sold, in a private placement sale to seven accredited investors, 605,000 shares at \$0.25 per share resulting in gross proceeds of \$151,250. Since this offering began, the price of our common stock has ranged from a low of \$0.25 to a high of \$0.36.

On December 28, 2007, the Company closed on a private placement sale of 2,497,000 shares to thirteen accredited investors at \$0.25 per share resulting in gross proceeds of \$624,250. This private placement sale had been underway since October 19, 2007. At the time of the offering, the price of our common stock ranged from a low of \$0.33 to a high of \$0.48.

On July 18, 2006, the Company closed on a private placement sale of 1,399,765 units at \$3.00 per unit resulting in gross proceeds of \$4,199,291. Each unit sold was comprised of one share of Series A Convertible Preferred stock and two common stock purchase warrants. The warrants are exercisable at a price of \$2.00 and expire on July 19, 2011. The 100 investors in this private placement were issued 1,399,765 shares of Series A Convertible Preferred stock and 2,799,527 common stock purchase warrants.

The placement agent for the offering earned an additional 419,930 common stock purchase warrants. At the time of the offering, the common stock component prices of the private placement units were significantly lower than the trading price of our common stock.

On May 19, 2006, the Company closed on a private placement sale of 4,013,602 units at \$1.50 per unit resulting in gross proceeds of \$6,020,404. Each unit sold was comprised of two shares of common stock and one common stock purchase warrant. The warrants are exercisable at a price of \$2.00 and expire on May 20, 2011. The 118 investors in this private placement were issued 8,027,206 shares of common stock and 4,013,602 common stock purchase warrants. The placement agent for the offering earned an additional 1,204,082 common stock purchase warrants. At the time of the offering, the common stock component prices of the private placement units were significantly lower than the trading price of our common stock.

In addition to the completed private placements, we may in the future, issue additional previously authorized and unissued common stock. These events may result in the further dilution of the ownership interests of our present shareholders and purchasers of common stock offered in this prospectus.

Historically we have, and likely will continue to issue additional shares of our common stock in connection with the compensation of personnel, future acquisitions, private placements, or for other business purposes. Future issuances of substantial amounts of these equity securities could have a material adverse effect on the market price of our common stock, and would result in further dilution of existing stock ownership.

Preferred stock has been issued with greater rights than the common stock issued which may dilute and depress the investment value of the common stock investments

Our articles of incorporation currently authorize the issuance of 10,000,000 shares of \$0.001 par value preferred stock. In June 2006, the Board of Directors authorized 2,400,000 shares of preferred stock to be designated as Series A Convertible Preferred stock. The Board of Directors has the power to issue shares without shareholder approval, and such shares can be issued with such rights, preferences, and limitations as may be determined by our Board of Directors.

On July 18, 2006, the Company closed on a private placement sale of 1,399,765 units at \$3.00 per unit resulting in gross proceeds of \$4,199,291. Each unit sold was comprised of one Series A Convertible Preferred share and two common stock purchase warrants. Each Series A Convertible Preferred share can be converted to three common stock shares at any time. The warrants are exercisable at a price of \$2.00 and expire on July 18, 2011. The 100 investors in this private placement were issued a total of 1,399,765 Series A Convertible Preferred shares and 2,799,527 common stock purchase warrants. The placement agent for the offering earned an additional 419,930 common stock purchase warrants.

As of February 29, 2008, 1,297,465 shares of Series A Convertible preferred stock were issued and outstanding. The rights of the holders of common stock are subject to and may be adversely affected by the rights and preferences afforded to the holders of these preferred shares. The rights and preferences of the issued preferred shares include:

- conversion into common stock of the Company anytime the preferred shareholder may wish;

- automatic convertibility into common stock if after the effective date of the registration statement the Company's common stock closes at or above \$3.00 per share for twenty (20) out of thirty trading days (30) days;
- cumulative dividends in the amount of 6% of the original purchase price per annum, payable upon declaration by the board of directors;
- the ability to vote together with the common stock with a number of votes equal to the number of shares of common stock to be issued upon conversion of the preferred stock.

The issuance of the Series A Convertible Preferred shares could delay, discourage, hinder or preclude an unsolicited acquisition of our Company. In addition, the issuance of these preferred shares could make it less likely that shareholders receive a premium for their shares as a result of any such attempt to acquire the Company. Further, this issuance could adversely affect the market price of, and the voting and other rights, of the holders of outstanding shares of common stock.

Although we have no current plans to issue any additional preferred stock, future issuances of preferred stock may also have more advantageous features than our common stock in terms of dividends, liquidation and voting rights.

We may seek to raise additional funds in the future through debt financing which may impose operational restrictions and may further dilute existing ownership interests

We expect to seek to raise additional capital in the future to help fund our acquisition, development, and production of oil and natural gas reserves. Debt financing, if available, may require restrictive covenants which may limit our operating flexibility. Future debt financing may also involve debt instruments that are convertible into or exercisable for common stock. As mentioned above, the conversion of the debt to equity financing may dilute the equity position of our shareholders.

Principal shareholders and directors control the Company through substantial voting power

Our two largest principal beneficial shareholders, along with six current directors and officers of the Company own and control about 25.5% percent of our outstanding common stock.

Our shareholders do not have the right to cumulative voting in the election of our directors. Cumulative voting could allow a minority group to elect at least one director to our board. Because there is no provision for cumulative voting, a minority group will not be able to elect any directors. Conversely, if our principal beneficial shareholders and directors wish to act in concert, they would be able to vote to appoint directors of their choice, and otherwise directly or indirectly, control the direction and operation of the Company.

We do not anticipate paying dividends on our common stock which could devalue the market value of these securities

We have not paid any cash dividends on our common stock since our inception. We do not anticipate paying cash dividends in the foreseeable future. Any dividends paid in the future will be at the complete discretion of our board of directors. For the foreseeable future, we anticipate that we will retain any revenues which we may generate from our operations. These retained revenues will be used to finance and develop the growth of the Company. Prospective investors should be aware that the absence of dividend payments could negatively affect the market value of our common stock.

Pursuant to SEC Rules our common stock is classified as a “penny stock” increasing the risk of investment in these shares

Our common stock is designated as “penny stock” and thus may be more illiquid than shares traded on an exchange or on NASDAQ. The SEC has adopted rules (Rules 15g-2 through 15g-6 of the Exchange Act) which define “penny stocks” and regulate broker-dealer practices in connection with transactions with these stocks. Penny stocks generally are any non-NASDAQ or non-exchange listed equity securities with a price of less than \$5.00, subject to certain exceptions. The “penny stock rules” require a broker-dealer to:

- deliver a standardized risk disclosure document prepared by the SEC;
- provide the customer with current bid and offer quotations for the penny stock;
- include the compensation of the broker-dealer and its salesperson in the transaction;
- provide monthly account statements showing the market value of each penny stock held in the customer’s account;
- make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser’s written agreement to the transaction.

The “penny stock” reporting and disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for a stock that is subject to these rules. The market liquidity for the shares could be severely and adversely affected by limiting the ability of broker-dealers to sell these shares. In addition, the ability of purchasers in this offering to sell their stock in any secondary market could be adversely restricted.

Due to limited and sporadic trading volume, investors may not be able to resell their shares of common stock at favorable times and prices

Although our common stock has been quoted on the OTC Bulletin Board for several years, the trading in our stock has been limited and sporadic. Although trading volume has increased over the past fiscal year, it has still been sporadic. The trading volume during this period has ranged from several hundred thousand shares to as few as no shares traded on certain days. A consistently active trading market for our common stock may never be developed, or sustained if it emerges. In addition, the price of our common stock on the OTC Bulletin Board has been extremely volatile. Low volume or lack of demand for these securities may make it more difficult for you to sell such shares at a price or at a time that would be favorable. We cannot assure you that you will be able to sell your shares at an attractive price relative to the price you are paying or that you will be able to sell these securities in a timely fashion.

An investment in the common stock of our Company will not provide any federal income tax benefits for the shareholders

Investors should be aware that they will not receive any of the federal income tax benefits available to individuals investing as limited partners in oil and gas partnership programs. Any income tax advantages will inure solely to the benefit of the Company and will not be passed through to any shareholders.

Risks Related to Our Industry

We are subject to complex laws and regulations that can negatively impact the cost, manner and feasibility of conducting our business

Our business is governed by numerous laws and regulations at various levels of government. These laws and regulations govern the operation and maintenance of our facilities, the discharge of materials into the environment and other environmental protection issues. These laws and regulations may, among other potential consequences, require that we:

- acquire permits before the commencement of drilling;
- restrict the substances that can be released into the environment with drilling and production activities;
- limit or prohibit drilling activities on protected areas;
- require that reclamation measures be taken to prevent pollution from former operations;
- require remedial measures to be taken with respect to contaminated property.

The costs of complying with environmental laws and regulations could negatively impact our financial condition and results of operations. Future changes in environmental laws and regulations could occur that may result in stricter standards and enforcement which could further negatively impact our business.

The volatility of oil and natural gas prices could adversely affect our business

Our future revenues, profitability and growth of our investments in oil and gas properties depend to a large degree on prevailing oil and gas prices. These prices tend to fluctuate significantly in response to factors beyond our control. These factors include, but are not limited to, the continued threat of escalating war in the Middle East and actions of the Organization of Petroleum Exporting Countries and its maintenance of production constraints. Additional factors include, the U.S. economic environment, weather conditions, the availability of alternate fuel sources, transportation interruption, the impact of drilling levels on crude oil and natural gas supply, and environmental issues. The prices for oil and natural gas have varied substantially over time based on general supply and demand and may in the future decline. These prices have been and are likely to remain volatile. Significant declines in these prices owing to this volatility will adversely affect our business and consequently our shareholders.

The success of our business is dependent on our ability to produce sufficient quantities of oil and gas which may be adversely affected by a number of factors outside of our control

The business of exploring for and producing oil and gas involves a substantial risk of investment loss. Drilling oil and gas wells involves the risk that the wells may be unproductive or that, although productive, that the wells may not produce oil and/or gas in economic quantities. Other hazards, such as unusual or unexpected geological formations, pressures, fires, blowouts, loss of circulation of drilling fluids may substantially delay or prevent completion of any well. Adverse weather conditions can also hinder drilling operations. In addition, a “productive well” (a well that is producing oil or gas or that is capable of production) may become uneconomic due to pressure depletion, water encroachment, mechanical difficulties, etc, which impair or prevent the production of oil and/or gas from the well; or, due to increased production costs.

There can be no assurance that oil and gas will be produced from the properties in which we have interests. Governmental permitting requirements and regulations may delay or deter drilling in some areas. Further, the marketability of any oil or gas that we acquire or discover may be influenced by numerous factors beyond our control. We cannot predict how these factors may affect our business.

The unavailability or high cost of drilling rigs and related equipment could adversely affect our ability to execute our exploration and exploitation plans on a timely and economic basis

Increased oil and natural gas prices have stimulated increased demand and resulted in escalated prices for drilling rigs, crews, and associated equipment, supplies and services. This demand has created a shortage of drilling rigs and crews as the number of wells being drilled have vastly increased. The inability to secure drilling rigs and crews may delay development of properties in which we acquire an interest, resulting in the untimely and costly expiration of certain leases. Drilling delays and the loss of leases could have a material negative effect on our business operations and financial condition.

Employees and Consultants

In December 2007, both the management and the Board of Directors of Daybreak were restructured to allow for future growth and increased efficiency within the Company. Robert N. Martin, President resigned from that position and was appointed Senior Vice-President, Exploration; Chief Executive Officer Eric L. Moe resigned from the Company; Timothy R. Lindsey formerly an outside director was appointed interim President and Chief Executive Officer; Chief Financial Officer Terrence J. Dunne resigned from the Company; and Controller Thomas C. Kilbourne resigned from that position but continued as an employee of Daybreak. James F. Westmoreland, formerly a finance and accounting consultant to Daybreak, was appointed interim Chief Financial Officer.

On December 18, 2007, the Board of Directors voted to reduce the number of Board positions to three. Subsequently, the following individuals resigned their positions and offices with the Board of Directors of Daybreak; Robert N. Martin, Eric L. Moe, Terrence J. Dunne, Jeffrey R. Dworkin, Thomas C. Kilbourne and Michael Curtis. Karol L. Adams, formerly a consultant to Daybreak, was appointed Corporate Secretary.

On March 24, 2008 James F. Meara was appointed to our Board of Directors. The addition of Mr. Meara expanded the Company's board to four members.

On April 3, 2008, James F. Westmoreland, formerly interim Chief Financial Officer, was appointed Executive Vice President and Chief Financial Officer; Karol L. Adams was appointed Chief Compliance Officer in addition to the Corporate Secretary duties; Thomas C. Kilbourne was appointed Controller and Assistant Secretary; and Daybreak adopted a series of corporate responsibility statements and employee guidelines.

We currently have seven employees located throughout four states. We may hire more employees in the next fiscal year as needed. All other services are currently contracted for with independent contractors. The Company has not obtained "key man" life insurance on any of its officers or directors.

The Daybreak Oil and Gas, Inc. corporate office is located at 601 W. Main Ave., Suite 1012, Spokane, Washington 99201-0613. Our telephone number is (509) 232-7674.

Our regional operations office is located at 16225 Park Ten Place, Suite 500, Houston, Texas 77084. The telephone number of our office in Houston is (281) 994-4021.

Availability of SEC Filings

You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. You can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is (<http://www.sec.gov>).

Website / Available Information

Our website can be found at www.daybreakoilandgas.com. Our Annual Reports on Form 10-KSB, Quarterly Reports on Form 10-QSB, Current Reports on Form 8-K and amendments to those reports filed or furnished with the U.S. Securities and Exchange Commission, or SEC, pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, or the Exchange Act, can be accessed free of charge on our web site at www.daybreakoilandgas.com on the "Shareholder Information" section of our web site under the "SEC Filings" button as soon as reasonably practicable after we electronically file such material with, or otherwise furnish it to, the Securities and Exchange Commission (the "SEC").

We have adopted an Ethical Business Conduct Policy Statement to provide guidance to our directors, officers and employees on matters of business conduct and ethics, including compliance standards and procedures. We also have adopted a Code of Ethics for Senior Financial Officers that applies to our principal executive officer, principal financial officer, principal accounting officer and controller. Our Ethical Business Conduct Policy Statement and Code of Ethics for Senior Financial Officers are available on the "Shareholder Information" section of our web site at www.daybreakoilandgas.com under the heading "Corporate Governance." We intend to promptly disclose via a Current Report on Form 8-K or via an update to our web site information any amendment to or waiver of these codes with respect to our executive officers and directors. Waiver information disclosed via the web site will remain on the web site for at least 12 months after the initial disclosure of a waiver. Our Corporate Governance Guidelines and the charters of our Audit Committee, Nominating and Corporate Governance Committee, and Compensation Committee are also available on the "Shareholder Information" section of our web site at www.daybreakoilandgas.com under the heading "Corporate Governance." In addition, copies of our Ethical Business Conduct Policy Statement, Code of Ethics for Senior Financial Officers, Corporate Governance Guidelines and the charters of the Committees referenced above are available at no cost to any shareholder who requests them by writing or telephoning us at the following address or telephone number:

Daybreak Oil and Gas, Inc.
601 W. Main Ave., Suite 1012
Spokane, WA 99201-0613
Attention: Corporate Secretary
Telephone: (509) 232-7674

Information contained on or connected to our web site is not incorporated by reference into this Annual Report and should not be considered part of this report or any other filing that we make with the SEC.

ITEM 2. DESCRIPTION OF PROPERTIES

We have onshore oil and gas projects underway throughout the United States. We have not filed any estimates of total, proved net oil or gas reserves with any Federal agency for the fiscal year ended February 29, 2008. Throughout this 10-KSB annual report oil is shown in barrels (“Bbl”), and of natural gas is shown in thousands of cubic feet (“Mcf”). The project areas that we are involved in are as follows:

Alabama (East Gilbertown Field)

Choctaw County. In December 2006, we acquired a working interest in an existing oil field project, the East Gilbertown Field (“Gilbertown”) that produces relatively heavy oil (approximately 18° API). This field has nineteen wellbores most of which are capable of production.

From December 2006 through March 2007, we incrementally increased our working interest in this project from 2.5% to 12.5%. On June 1, 2007, we became the operator of the Gilbertown. Future plans are to continue to increase production in the field by bringing more non-producing wellbores back into production. As of February 29, 2008, we had spent \$397,229 in leasehold, production and workover costs associated with this field. We plan to spend approximately \$200,000 in capital repairs and new investments within the field in the upcoming fiscal year.

Reserves

At March 1, 2008 we had net proved reserves of 2,391 Bbls. (“Barrels”) of oil in Gilbertown according to SEC guidelines as determined by the certified independent engineering firm Huddleston & Co., Inc.

California

East Slopes Project in Kern and Tulare Counties. In May 2005, we agreed to jointly explore an Area of Mutual Interest (“AMI”) in the southeastern part of the San Joaquin Basin. For our 50% interest we initially paid a \$12,500 fee to secure the project and the geological concepts. Our agreement calls for us to also pay another \$5,000 fee upon the completion of each sub-regional lead that is developed from a 3-D seismic survey. Additionally, we agreed to pay another \$5,000 fee upon the spud of the first well in each prospect area.

Four prospect areas have been identified and we are actively leasing lands in the East Slopes project area. Additionally, we have identified two prospect areas to the north of the East Slopes AMI. This second AMI is referred to as the “Expanded AMI” project area. We have now jointly leased about 25,633 undeveloped acres in the two AMI’s. Drilling targets are porous and permeable sandstone reservoirs at depths of 1,200 feet to 4,000 feet. Daybreak has a 50% of the working interest in the area that is not in the Chevron partnered East Slopes AMI project area covered by the recently completed high definition 3-D seismic survey.

As of February 29, 2008 we have spent \$778,806 in leasehold and geologic and geophysical costs associated with this project.

In June 2007, Daybreak and its partners (“Daybreak et al”), entered into a Seismic Option Farmout Agreement with Chevron U.S.A. Inc. (“Chevron”), for a seismic and drilling program in the East Slopes (Kern County) project area.

By paying the full cost of the seismic program Chevron has earned a 50% interest in the Daybreak et al lands and a 50% working interest for the drilling of future wells in the project area after the drilling of the first four wells. Daybreak et al will earn a 50% (Daybreak 25%) interest in the Chevron lands located in the same project area, by paying 100% of the cost of the first four initial test wells to be drilled on the jointly held lands. The four initial test wells must be drilled within nine months of the seismic data interpretation being completed. In January 2008, we announced that data processing is underway following the recently completed field acquisition of the 35 square-mile high resolution 3-D seismic survey. As of the date of this report, we have currently identified 12 potential drilling locations from ongoing interpretation of the seismic data. Drilling is expected to commence in the second fiscal quarter of 2008. We plan to spend approximately \$2,000,000 in new capital investments within the AMI covering the Seismic Option area in the upcoming fiscal year.

Louisiana

Tuscaloosa Project in Tensas and Franklin Parishes. On January 18, 2008 we signed a purchase and sale agreement (“PSA”) for the sale of our project interests for \$8 million in cash. The transaction closed in three tranches; the first closing for \$2 million occurred on January 18, 2008; the second closing for \$500,000 occurred on April 30, 2008; and the final closing for \$5.5 million occurred on June 12, 2008 and was subject to customary closing adjustments. The sale includes Daybreak’s interests in the Tensas Farms et al F-1, F-3, B-1, A-1 and F-2 wells; and all of its acreage and infrastructure in the project area. Under terms of the PSA, the effective date for each closing was January 1, 2008.

Reserves

At March 1, 2008 we had net proved reserves of 31.8 MMcf of gas and 10,567 Bbls. of oil in the Tuscaloosa Project according to SEC guidelines as determined by the certified independent engineering firm Huddleston & Co., Inc.

The Krotz Springs Project in St. Landry Parish is a deep gas play with current net production from a Cockfield Sands reservoir. Daybreak was the operator for this project during the drilling and completion phases of this single well. When production commenced in May of 2007, the unitized field operator of the Krotz Springs Field became the operator for this well. Total project drilling and completion costs were approximately \$9.2 million. We have a 12.5% working interest in this project, with a net revenue interest (“NRI”) of 9.125%. As of February 29, 2008, we had spent \$1.16 million in leasehold, drilling, completion and production costs associated with this project. Current production is being evaluated prior to recompleting another prospective producing zone in the well in which Daybreak will spend approximately \$25,000 in the upcoming fiscal year.

Reserves

At March 1, 2008 we had net proved reserves of 4.6 MMcf (million cubic feet) of gas and 46 Bbls. of oil in the Krotz Springs Project according to SEC guidelines as determined by the certified independent engineering firm Huddleston & Co., Inc.

The North Shuteston Prospect, also in St. Landry Parish is a three dimensional (“3-D”) seismic objective supported by a shallow amplitude anomaly at a depth of 2,300 feet. This anomaly is related to a Miocene Age Sand. On April 23, 2008, we conveyed our interest in this project to another party in exchange for a two percent (2.0%) overriding royalty interest (“ORRI”) in the production revenue from the start of production.

Drilling will begin on this project during the summer of 2008; however, Daybreak no longer has a working interest in this project, and therefore will not have any more capital investment. As of February 29, 2008, we had spent about \$130,000 in leasehold, geologic and geophysical (“G&G”) and project management costs associated with this project.

Avoyelles Parish. This Prospect is a Cretaceous target positioned beneath an existing oilfield that has produced over 28 million barrels of oil. The project is focused on the broad northeast flank of the Cretaceous structure, targeting the Massive Sand of the Lower Tuscaloosa Formation; and, the Fractured Lower (Austin) Chalk. Plans call for a 3-D seismic survey covering about 36 square miles. This is primarily a deep gas play. Gross project costs are estimated to be \$1,000,000 for land, \$3,000,000 for 3-D Seismic and \$6,000,000 for drilling the first well. We have jointly acquired leases or permits on approximately 2,002 gross undeveloped acres within the AMI. Daybreak has a 35% working interest in this project. As of February 29, 2008, we had spent \$431,484 in leasehold, seismic and project management costs associated with this exploration project. We and our existing working interest partners endeavor to secure other industry partners to participate in additional land acquisition and seismic costs before proceeding with drilling. We are not planning on spending any funds in capital new investments within the field in the upcoming fiscal year.

Texas

Nueces County. In November 2005, we agreed to jointly participate in a five well re-entry project in the Saxet Deep Field (“Saxet”) a previously produced oilfield, on a developed 320 acre lease. The project is located within the city limits of Corpus Christi, Texas, near the airport. We have a variable working interest in the project, with an average well working interest of 25.24% and an NRI of 14.25% on all production from these wells.

In May 2006, we started the re-work of the first well, the Weil 8-C well. This well was successfully reworked and placed into production in August 2006. In August and September 2006, we re-entered and started to produce from both the Weil 3-C and Weil 7-C wells. Two other wells the Weil 2-C and Weil 6-C were re-entered in September and October of 2006, and are now being used as salt water disposal wells.

As of February 29, 2008, we had spent \$702,569 in leasehold, workover, production, pipeline and production facility costs associated with this project.

We have continued to face increased production costs in the Saxet with a workover required on an existing salt water disposal well. The workover was completed in late September 2007. We anticipate being able to continue production of the field; however, there is no assurance that commercial returns will continue. We plan on spending approximately \$50,000 in capital new investments within the field in the upcoming fiscal year.

Reserves

At March 1, 2008 we had net proved reserves of 29.2 MMcf of gas and 109 Bbls. of oil in the Saxet according to SEC guidelines as determined by the certified independent engineering firm Huddleston & Co., Inc.

Total Reserves

At March 1, 2008 we had net proved reserves of 65.5 MMcf of gas and 13,113 Bbls. of oil from all of our projects in total according to SEC guidelines as determined by the certified independent engineering firm Huddleston & Co., Inc.

Summary Operating Data

The production and revenue shown in the following table is Daybreak's net share of annual production and revenue based on the Net Revenue Interest ("NRI") in each project as of February 29, 2008. Oil is shown in barrels ("Bbl"), and natural gas is shown in thousands of cubic feet ("Mcf").

<u>State</u>	<u>Field</u>	<u>Oil</u>		<u>Gas</u>	
		<u>Net Barrels</u>	<u>Net Revenue</u>	<u>Net Mcf</u>	<u>Net Revenue</u>
Louisiana	Tuscaloosa	4,231	\$ 359,012	37,641	\$ 291,742
	Krotz Springs	89	7,141	7,777	67,599
Texas	Saxet	236	17,679	22,063	155,222
Alabama	Gilbertown	2,235	119,209	-	-
Total		6,791	\$ 503,041	67,481	\$ 514,563

The following table shows the average sales price per unit of oil and natural gas as well as the average cost of production in barrels of oil equivalent ("BOE") conversion, for the past three fiscal years. One barrel of oil is roughly equivalent to 6,000 cubic feet of natural gas. Oil is shown in barrels ("Bbl"), and natural gas is shown in thousands of cubic feet ("Mcf").

	<u>Years Ended,</u>	
	<u>February 29,</u> <u>2008</u>	<u>February 28,</u> <u>2007</u>
Average Sales Price:		
Gas (per Mcf)	\$ 7.63	\$ 6.62
Oil (per Bbl)	\$ 74.84	\$ 65.10
Average Cost of Production:		
Oil (per Bbl)	\$ 25.12	\$ 24.81

The following table shows the developed and undeveloped oil and gas lease acreage held by us as of February 29, 2008. Undeveloped acres are acres on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil and gas. Gross acres are the total number of acres in which we have an interest. Net acres are the sum of our fractional interests owned in the gross acres.

Location	Developed Acres		Undeveloped Acres	
	Gross	Net	Gross	Net
Alabama	2,025	253	-	-
Texas	320	81	-	-
Louisiana	6,762	2,803	13,524	5,606
California			25,633	12,817
Total	9,107	3,137	39,157	18,423

The following table summarizes our productive oil and gas wells as of February 29, 2008. Productive wells are producing wells and wells capable of production. Gross wells are the total number of wells in which we have an interest. Net wells are the sum of our fractional interests owned in the gross wells.

State	Field	Gross	Net
Louisiana	Tuscaloosa	3	1.25
	Krotz Springs	1	0.13
Texas	Saxet	3	0.76
Alabama	Gilbertown	19	2.38
Total		26	4.5

The following table shows our exploratory well drilling activity for fiscal years ended February 28, 2007 and February 29, 2008.

State	Fiscal Year 2008		Fiscal Year 2007	
	Productive	Dry	Productive	Dry
Louisiana	2	1	2	1
Texas	-	-	-	-
Canada	-	-	-	1

ITEM 3. LEGAL PROCEEDINGS

In a lawsuit filed on January 12, 2008, in East Baton Rouge Parish, State of Louisiana, entitled, "Daybreak Oil and Gas, Inc. versus California Oil & Gas Corporation, Suit No. 562933, Section 24, 19th Judicial District Court," Daybreak seeks judgment in the amount of \$587,465, together with legal interest thereon from the date of judicial demand until paid, for reasonable attorney fees on both principal and interest, and all costs of the proceedings.

Under the Joint Operating Agreement for the Krotz Springs Project, California Oil & Gas Corporation ("COGC") was responsible for its twenty-five percent (25%) share of the working interest costs related to drilling and completing the Haas-Hirsch #1 well in the Krotz Springs Project. As part of the drilling and completion of the Haas-Hirsch #1 well, Daybreak incurred certain costs and expenses on behalf of the various working interests associated with the well. COGC was periodically sent invoices for its 25% share of these costs. COGC has made partial payments pursuant to these periodic invoices. COGC, however, has not made full payment.

As a result, Daybreak has instituted this lawsuit. Service of this lawsuit has been perfected on COGC in Calgary, Alberta, Canada. A hearing date in court has been set for the end of May, 2008.

On May 1, 2008, Daybreak received \$108,428 from the unitized field operator of the Krotz Spings Project, who had been holding the production revenue of COGC in suspense under instructions from Daybreak. This amount, representing net production revenue from May 2007 through February 2008, will be applied to the original claim.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of the fiscal year ended February 29, 2008, we did not have any matters submitted to a vote of our security holders of the Company.

PART II

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

Our Common Stock is quoted in the over the counter market on the OTC Bulletin Board under the symbol "DBRM.OB". From July 2007 to December 13, 2007, our stock was quoted in the OTC pink sheet market, due to SEC filing delinquencies. We returned to being quoted on the OTC Bulletin Board market after the filing of our second fiscal quarter 2008 10-QSB report. The following table shows the high and low closing sales prices for the Common Stock for the two most recent fiscal years. The quotations reflect inter-dealer prices, without retail mark-up, markdown or commission and may not represent actual transactions. The information is derived from information received from online stock quotation services.

	Fiscal Year Ending February 28, 2007	
	High Closing	Low Closing
First Quarter	\$ 2.95	\$ 1.66
Second Quarter	\$ 2.77	\$ 1.85
Third Quarter	\$ 1.92	\$ 1.02
Fourth Quarter	\$ 1.30	\$ 0.94

	Fiscal Year Ending February 29, 2008	
	High Closing	Low Closing
First Quarter	\$ 0.95	\$ 0.48
Second Quarter	\$ 0.70	\$ 0.39
Third Quarter	\$ 0.62	\$ 0.35
Fourth Quarter	\$ 0.45	\$ 0.25

Dividend Policy

The Company has not declared or paid cash dividends or made distributions in the past, and the Company does not anticipate that it will pay cash dividends or make distributions in the foreseeable future.

As of February 29, 2008, the Company had 2,333 shareholders of record. This number does not include an indeterminate number of shareholders whose shares are held by brokers in street name.

Recent Sales of Unregistered Securities

Convertible Debentures

- From March 19, 2005 through August 31, 2005, we borrowed \$168,821 from six shareholders, officers or directors through a series of twenty-seven convertible debentures to finance our operating activities. These convertible debentures had the following features: one year term, six percent interest rate and the notes were convertible after six months to unregistered common stock.

A conversion rate of \$0.25 per share was selected because a private placement offering of our common stock was being planned at the same time for that price. Both the principal and the accrued interest were eligible for conversion to unregistered common stock.

During the fiscal year ended February 28, 2006, twenty-four of the convertible debentures representing \$136,821 in principal were converted resulting in 566,135 shares of unregistered common stock being issued to satisfy the principal and interest obligations. By February 28, 2007, all twenty-seven of the debentures were converted resulting in a total of 703,675 shares of unregistered common stock being issued to satisfy principal and interest obligations. The convertible debenture, shares issued upon conversion of the debenture and shares issued for interest were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

In accordance with EITF 00-27 and 98-5, the Company determined that the debentures issued integrated a beneficial conversion feature (BCF). The Company recorded a discount of \$73,511 to reflect the BCF feature on the debentures at the date of issuance. Utilizing the effective interest method, these discounts have been amortized over the period commencing from the issuance date to the date of stated redemption (i.e. maturity) of the debt in accordance with EITF 00-27. The discount of \$73,511 was fully amortized at February 28, 2007.

The Company has evaluated the application of SFAS No. 133 and EITF 00-19 for the consideration of embedded derivatives with respect to the conversion feature of the convertible debentures relative to the guidance of these pronouncements, the Company has concluded that these debentures did not contain embedded derivatives.

The following is a listing of the twenty-seven convertible debentures that occurred:

1) On March 19, 2005, Terrence Dunne (former Chief Financial Officer and director), a shareholder and 10% control person (at the time), loaned the Company \$623 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.47. On November 28, 2005, Mr. Dunne converted the note plus interest into unregistered common stock. He was issued 2,593 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$1,296.

2) On March 22, 2005, Terrence Dunne (former Chief Financial Officer and director), a shareholder and 10% control person (at the time), loaned the Company \$10,216 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.50. On November 28, 2005, Mr. Dunne converted the note plus interest into unregistered common stock. He was issued 42,503 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$21,249.

3) On March 23, 2005, Dale Lavigne, a director and shareholder, loaned the Company \$15,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.48. On November 28, 2005, Mr. Lavigne converted the note plus interest into unregistered common stock. He was issued 62,397 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$31,200.

4) On March 23, 2005, Ronald Lavigne, a director and shareholder, loaned the Company \$3,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.48. On November 28, 2005, Mr. Lavigne converted the note plus interest into unregistered common stock. He was issued 12,479 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$6,240.

5) On March 25, 2005, Thomas Kilbourne (former Treasurer and director) a shareholder loaned the Company \$3,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.37. On November 28, 2005, Mr. Kilbourne converted the note plus interest into unregistered common stock. He was issued 12,475 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$6,240.

6) On March 25, 2005, Robert O'Brien, a shareholder and ten percent (10%) control person (at the time), loaned the Company \$15,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.37. On August 31, 2006, Mr. O'Brien converted the note plus interest into unregistered common stock. He was issued 65,168 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.92. Based on the closing price, the value of the principal in the conversion was \$125,123.

7) On April 25, 2005, Terrence Dunne (former Chief Financial Officer and director), a shareholder and 10% control person (at the time), loaned the Company \$8,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.35. On November 28, 2005, Mr. Dunne converted the note plus interest into unregistered common stock. He was issued 33,105 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$16,640.

8) On April 25, 2005, Dale Lavigne, a director and shareholder, loaned the Company \$8,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.35. On November 28, 2005, Mr. Lavigne converted the note plus interest into unregistered common stock. He was issued 33,105 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$16,640.

9) On April 26, 2005, Ronald Lavigne, a director and shareholder, loaned the Company \$3,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.35. On November 28, 2005, Mr. Lavigne converted the note plus interest into unregistered common stock. He was issued 12,412 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$6,240.

10) On April 26, 2005, Thomas Kilbourne (former Treasurer and director) a shareholder, loaned the Company \$3,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.35. On November 28, 2005, Mr. Kilbourne converted the note plus interest into unregistered common stock. He was issued 12,412 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$6,240.

11) On May 26, 2005, Terrence Dunne (former Chief Financial Officer and director), a shareholder and 10% control person (at the time), loaned the Company \$3,982 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.33. On November 30, 2005, Mr. Dunne converted the note plus interest into unregistered common stock. He was issued 16,418 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$8,283.

12) On May 31, 2005, Thomas Kilbourne (former Treasurer and director) a shareholder, loaned the Company \$3,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.32. On November 30, 2005, Mr. Kilbourne converted the note plus interest into unregistered common stock. He was issued 12,361 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.52. Based on the closing price, the value of the principal in the conversion was \$6,240.

13) On June 16, 2005, Terrence Dunne (former Chief Financial Officer and director), a shareholder and 10% control person (at the time), loaned the Company \$10,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.33. On February 10, 2006, Mr. Dunne converted the note plus interest into unregistered common stock. He was issued 41,558 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.70. Based on the closing price, the value of the principal in the conversion was \$68,000.

14) On July 8, 2005, Golconda Mining Company, a shareholder, loaned the Company \$10,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.32. On January 25, 2006, Golconda Mining Company converted the note plus interest into unregistered common stock. They were issued 41,315 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.54. Based on the closing price, the value of the principal in the conversion was \$61,600.

15) On July 27, 2005, Terrence Dunne (former Chief Financial Officer and director), a shareholder and 10% control person (at the time), loaned the Company \$13,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.25. On February 10, 2006, Mr. Dunne converted the note plus interest into unregistered common stock. He was issued 53,675 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.70. Based on the closing price, the value of the principal in the conversion was \$88,400.

16) On July 27, 2005, Thomas Kilbourne (former Treasurer and director) a shareholder, loaned the Company \$6,500 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.25. On February 10, 2006, Mr. Kilbourne converted the note plus interest into unregistered common stock. He was issued 26,838 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.70. Based on the closing price, the value of the principal in the conversion was \$44,200.

17) On July 27, 2005, Robert O'Brien, a shareholder and ten percent (10%) control person (at the time), loaned the Company \$12,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.25. On August 31, 2006, Mr. O'Brien converted the note plus interest into unregistered common stock. He was issued 51,156 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.92. Based on the closing price, the value of the principal in the conversion was \$98,220.

18) On August 1, 2005, Dale Lavigne, a director and shareholder, loaned the Company \$5,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.30. On February 10, 2006, Mr. Lavigne converted the note plus interest into unregistered common stock. He was issued 20,628 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.70. Based on the closing price, the value of the principal in the conversion was \$34,000.

19) On August 1, 2005, Thomas Kilbourne (former Treasurer and director) a shareholder, loaned the Company \$500 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.30. On February 10, 2006, Mr. Kilbourne converted the note plus interest into unregistered common stock. He was issued 2,063 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.70. Based on the closing price, the value of the principal in the conversion was \$3,400.

20) On August 2, 2005, Ronald Lavigne, a director and shareholder, loaned the Company \$5,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.28. On February 10, 2006, Mr. Lavigne converted the note plus interest into unregistered common stock. He was issued 20,625 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.70. Based on the closing price, the value of the principal in the conversion was \$34,000.

21) On August 22, 2005, Thomas Kilbourne (former Treasurer and director) a shareholder, loaned the Company \$5,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.44. On February 28, 2006, Mr. Kilbourne converted the note plus interest into unregistered common stock. He was issued 20,625 shares of stock from this conversion. On the day of the conversion the closing price of our stock was \$2.25. Based on the closing price, the value of the principal in the conversion was \$45,000.

22) On August 24, 2005, Terrence Dunne (former Chief Financial Officer and director), a shareholder and 10% control person (at the time), loaned the Company \$6,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.42. On February 28, 2006, Mr. Dunne converted the note plus interest into unregistered common stock. He was issued 24,742 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$2.25. Based on the closing price, the value of the principal in the conversion was \$54,000.

23) On August 26, 2005, Terrence Dunne (former Chief Financial Officer and director), a shareholder and 10% control person (at the time), loaned the Company \$6,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.40. On February 28, 2006, Mr. Dunne converted the note plus interest into unregistered common stock. He was issued 24,734 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$2.25. Based on the closing price, the value of the principal in the conversion was \$54,000.

24) On August 26, 2005, Robert O'Brien, a shareholder and ten percent (10%) control person (at the time), loaned the Company \$5,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.40. On August 31, 2006, Mr. O'Brien converted the note plus interest into unregistered common stock. He was issued 21,216 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$1.92. Based on the closing price, the value of the principal in the conversion was \$40,735.

25) On August 31, 2005, Ronald Lavigne, a director and shareholder, loaned the Company \$2,500 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.37. On February 28, 2006, Mr. Lavigne converted the note plus interest into unregistered common stock. He was issued 10,298 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$2.25. Based on the closing price, the value of the principal in the conversion was \$22,500.

26) On August 31, 2005, Thomas Kilbourne (former Treasurer and director) a shareholder, loaned the Company \$2,500 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.37. On February 28, 2006, Mr. Kilbourne converted the note plus interest into unregistered common stock. He was issued 10,298 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$2.25. Based on the closing price, the value of the principal in the conversion was \$22,500.

27) On August 31, 2005, Terrence Dunne (former Chief Financial Officer and director), a shareholder and 10% control person (at the time), loaned the Company \$4,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$0.37. On February 28, 2006, Mr. Dunne converted the note plus interest into unregistered common stock. He was issued 16,476 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$2.25. Based on the closing price, the value of the principal in the conversion was \$36,000.

- Between January 25, 2006 and February 8, 2006, the Company borrowed a total of \$806,700 from seven shareholders in eight loans to finance exploration activities as well as increase operating capital. The term of these convertible debentures was for one year at a 10% interest rate. The debentures were convertible to unregistered common stock after 61 days from the date of issuance. The conversion rate was \$0.50 per share.

As of February 28, 2007, all of these debentures had been converted to unregistered common stock. The convertible debenture, shares issued upon conversion of the debenture and shares issued for interest were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

In accordance with EITF 00-27 and 98-5, the Company determined that the debentures issued integrated a beneficial conversion feature (BCF). The Company recorded a discount of \$806,700 to reflect the BCF feature at the date of issuance. Utilizing the effective interest method, these discounts have been amortized over the period commencing on the issuance date to the date of stated redemption (i.e. maturity) of the debt in accordance with EITF 00-27. The discount of \$806,700 was fully amortized at February 28, 2007.

The Company has evaluated the application of SFAS No. 133 and EITF 00-19 for the consideration of embedded derivatives with respect to the conversion feature of the convertible debentures relative to the guidance of these pronouncements, the Company has concluded that these debentures did not contain embedded derivatives

The following is a list of the eight convertible debentures that occurred:

1) On January 25, 2006, Michael Schneider, a shareholder loaned the Company \$50,000 to finance ongoing operating expenses. The loan agreement term was for one year at a 10% interest rate. The loan could be converted to unregistered common stock at the end of the term. The conversion rate was \$0.50 per share. On January 25, 2007, Mr. Schneider converted the debenture plus interest into unregistered common stock. He was issued 102,055 shares of stock from this conversion. On the day of the conversion the closing price of our stock was \$1.14. Based on the closing price, the value of the principal in the conversion was \$114,000.

2) On January 27, 2006, Thomas Hallett, a shareholder loaned the Company \$175,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$1.60. On February 27, 2007, Mr. Schneider converted the debenture plus interest into unregistered common stock. He was issued 385,000 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$.95. Based on the closing price, the value of the principal in the conversion was \$332,500.

3) On January 27, 2006, the Hooper Group, a shareholder and company controlled by Keith Hooper a greater than 5% shareholder (at the time), loaned the Company \$200,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$1.60. On February 27, 2007, the Hooper Group converted the debenture plus interest into unregistered common stock. They were issued 440,000 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$.95. Based on the closing price, the value of the principal in the conversion was \$380,000.

4) On January 30, 2006, W. Stanley Hooper, a shareholder loaned the Company \$100,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$1.63. On February 27, 2007, Mr. Hooper converted the debenture plus interest into unregistered common stock. He was issued 220,000 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$.95. Based on the closing price, the value of the principal in the conversion was \$190,000.

5) On February 1, 2006, Daniel McKinney, a shareholder loaned the Company \$101,700 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$1.59. On February 27, 2007, Mr. Schneider converted the debenture plus interest into unregistered common stock. He was issued 223,740 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$.95. Based on the closing price, the value of the principal in the conversion was \$193,230.

6) On February 1, 2006, Moreland Properties, a shareholder and company controlled by W. Douglas Moreland loaned the Company \$50,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$1.59. On February 27, 2007, Moreland Properties converted the debenture plus interest into unregistered common stock. They were issued 110,000 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$.95. Based on the closing price, the value of the principal in the conversion was \$95,000.

7) On February 2, 2006, James McQuade, a shareholder loaned the Company \$100,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$1.55. On February 27, 2007, James McQuade converted the debenture plus interest into unregistered common stock. He was issued 220,000 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$.95. Based on the closing price, the value of the principal in the conversion was \$190,000.

8) On February 8, 2006, Michael Schneider, a shareholder loaned the Company \$30,000 to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$1.52. On February 27, 2007, Mr. Schneider converted the debenture plus interest into unregistered common stock. He was issued 66,000 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$.95. Based on the closing price, the value of the principal in the conversion was \$57,000.

- In February and March 2006, we borrowed \$325,001 from four shareholders to finance operating capital needs. Three of the loans were in the form of convertible debentures. The fourth loan was in the form of a loan agreement. The term of all four loans, was for one year at a 10% interest rate. They were convertible to unregistered common stock after 61 days from the date of issuance. The conversion rate is \$0.75 per share.

As of February 28, 2007, the loan agreement had been converted to unregistered common stock. The loan agreement shares issued upon conversion of the loan and shares issued for interest were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

In December 2006, the three convertible debenture holders agreed to extend the term of the debentures to August 31, 2007. In consideration of the term extension, they were issued 150,001 warrants exercisable at \$2.00 for a period of five years. The warrants were valued at \$119,283 using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.7%; the current stock price at date of issuance of \$1.04 per share; the exercise price of the warrants of \$2.00; the term of five years; volatility of 117%; and dividend yield of 0.0%. The value of the warrants was recognized at the time of issuance as a discount against the existing convertible debentures and was amortized using the effective interest method until maturity.

On April 30, 2007, one of the convertible debenture holders converted to Daybreak unregistered common stock. A total of 37,169 shares were issued to satisfy the principal and interest obligation.

On August 31, 2007, the remaining two convertible debenture holders agreed to extend the term of the debentures to October 31, 2007. In consideration of the term extension they received 112,000 warrants. The warrants were valued at \$35,386 using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.1 %; the current stock price at date of issuance of \$0.53 per share; the exercise price of the warrants of \$0.53; the term of two years; volatility of 114%; and dividend yield of 0.0%. The value of the warrants was recognized at the time of issuance as a discount against the existing convertible debentures and was amortized using the effective interest method until maturity.

On October 31, 2007, one of the two remaining convertible debenture holders chose to receive a payoff of \$76,756.87 representing the principal plus accumulated interest of the convertible debenture. The other convertible debenture holder agreed to extend the term of his debenture until January 31, 2008.

In consideration of the term extension he received 90,000 warrants. The warrants were valued at \$25,587 using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 3.9 %; the current stock price at date of issuance of \$0.40 per share; the exercise price of the warrants of \$0.25; the term of two years; volatility of 121.64%; and dividend yield of 0.0%. The value of the warrants was recognized at the time of issuance as a discount against the existing convertible debentures and was amortized using the effective interest method until maturity.

On January 31, 2008, the remaining convertible debenture holder received a payoff of \$128,151.71 representing the principal plus accumulated interest of the convertible debenture.

In accordance with EITF 00-27 and 98-5, the Company determined that the debentures issued integrated a beneficial conversion feature (BCF). The Company has recorded a discount of \$325,001 to reflect the BCF feature over this period. The beneficial conversion features were recognized as discounts on the debentures at the date of issuance. Utilizing the effective interest method, these discounts have been amortized over the period commencing on the issuance date to the date of stated redemption (i.e. maturity) of the debt in accordance with EITF 00-27 rather than EITF 98-5. The discount of \$325,001 was fully amortized at February 28, 2007.

The Company has evaluated the application of SFAS No. 133 and EITF 00-19 for the consideration of embedded derivatives with respect to the conversion feature of the convertible debentures relative to the guidance of these pronouncements, the Company has concluded that these debentures did not contain embedded derivatives

The following is a list of the loan agreement and the three convertible debentures that occurred:

1) On February 24, 2006, Genesis Financial, Inc., a shareholder loaned the Company \$100,000 in a Loan Agreement to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$2.50. On June 6, 2006, Genesis Financial converted the note plus interest into unregistered common stock. They were issued 137,023 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$2.30. Based on the closing price, the value of the principal in the conversion was \$306,666. The convertible note, shares issued upon conversion of the loan agreement and shares issued for interest were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

2) On February 27, 2006, Daniel McKinney, a shareholder loaned the Company \$125,001 in a Convertible Debenture to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$2.21. On December 28, 2006, Mr. McKinney agreed to extend the term of the debenture to August 31, 2007. In consideration of this extension, he was issued 83,333 warrants. On August 31, 2007, Mr. KcKinney agreed to extend the term of the debenture to October 31, 2007. In consideration of this extension, he was issued 70,000 warrants. On October 31, 2007, Mr. McKinney again agreed to extend the term of the debenture to January 31, 2008. At the end of the term Mr. McKinney was paid in full and the debenture was cancelled. The convertible note and warrants issued upon extension of the term of the note were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

3) On February 28, 2006, James McQuade, a shareholder loaned the Company \$75,000 in a Convertible Debenture to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$2.25. On December 29, 2006, Mr. McQuade agreed to extend the term of the debenture to August 31, 2007. In consideration of this extension, he was issued 50,000 warrants. On August 31, 2007, Mr. McQuade agreed to extend the term of the debenture to October 31, 2007. In consideration of this extension, he was issued 42,000 warrants. On October 31, 2007, Mr. McQuade was paid in full and the debenture was cancelled. The convertible note and warrants issued upon extension of the term of the note were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

4) On March 6, 2006, Michael Schneider, a shareholder loaned the Company \$25,000 in a Convertible Debenture to finance ongoing operating expenses. On the day of the loan, the closing price of our stock was \$2.65. On January 16, 2007, Mr. Schneider agreed to extend the term of the debenture to August 31, 2007. In consideration of this extension, he was issued 16,668 warrants. On April 30, 2007, Mr. Schneider converted the note plus interest into unregistered common stock. He was issued 37,169 shares of stock from this conversion. On the day of the conversion, the closing price of our stock was \$0.56. Based on the closing price, the value of the principal in the conversion was \$18,667. The convertible debenture, warrants, shares issued upon conversion of the debenture and shares issued for interest were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

Warehousing Line of Credit and Convertible Promissory Note

- On December 19, 2005, we received an advance of \$60,000 on a warehousing line of credit from Genesis Financial Inc., to finance operating activities. This warehousing line of credit for \$180,000 was set up to fund the completion costs of the Ginny South Prospect in Texas. When the exploratory well was plugged and abandoned, the remaining balance of this line of credit was not utilized and was therefore cancelled.

The \$60,000 advance, in the form of a Convertible Promissory Note, had no stated interest and had the option to convert the note into Daybreak's common stock at any time until the June 30, 2006 maturity date of the note. In February 2006, the \$60,000 advance on the line of credit, as secured by the Convertible Promissory Note, was converted into unregistered common stock of Daybreak which resulted in 240,000 shares of stock being issued. The shares issued upon conversion of the line of credit were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

No discount was recorded for the imputed interest rate on the Convertible Promissory Note as a beneficial conversion feature of \$60,000 was recognized upon issuance in accordance with EITF 00-27 and 98-5. The beneficial conversion feature was recognized as a discount on the Convertible Promissory Note and amortized utilizing the effective interest method, over the period commencing on the issuance date to the date of stated redemption (i.e. maturity) of the debt in accordance with EITF 00-27.

Upon conversion, the remaining discount was recognized as interest and the Convertible Promissory Note was cancelled. Financing costs for the Convertible Promissory Note were paid by issuing 66,000 shares of unregistered common stock to Genesis Financial and the director who guaranteed Convertible Promissory Note as explained below. The common stock fair value of \$38,380 was recognized as interest expense on the date of grant and the fair value was determined using Daybreak's trading price on the date of grant.

- On December 19, 2005, we issued 30,000 shares of unregistered common stock to Terrence Dunne (former Chief Financial Officer and director) for his personal guarantee on the Genesis Financial Convertible Promissory Note. The fair value of the common stock shares was determined using our trading price on the date of grant and were recorded as interest expense. The shares issued for services were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

Private Placements

- Commencing on June 7, 2005 and closing on December 19, 2005, we conducted an unregistered offering through a private placement offering of our common stock for \$0.25 per share. Gross proceeds of \$1,100,000 were raised from the sale and generated net proceeds of \$1,087,500. A total of forty-three (43) investors participated in this private placement. From this offering, 4,400,000 shares of unregistered common stock were issued. We did not engage a placement agent for this offering, instead all the shares were sold directly by the Company. The trading prices of the common stock during the private placement period ranged from a low of \$ 0.23 per share to a high of \$ 0.65 per share. The proceeds from this offering were allocated to the following expenditures:

Mineral rights acquisition;
Drilling wells;
Seismic exploration;
General and administrative expenses;
Legal and accounting expenses.

The shares were offered and sold pursuant to a Regulation D exemption from the registration requirements of the Securities Act of 1933, as amended. The shares were offered and sold only to accredited investors.

- Commencing on March 3, 2006 and closing on May 19, 2006, we conducted a private placement offering of our common stock. Bathgate Capital Partners LLC, of Denver, Colorado was the placement agent. We offered “units” for sale, which were comprised of two shares of common stock and one common stock purchase warrant (warrant). The units sold for \$1.50 per unit, gross proceeds from the sale were \$6,020,404, which equated to 4,013,602 units. Our net proceeds were \$5,188,257 and the placement agent’s commission and other expenses equaled \$832,147.

A total of 118 investors participated in this private placement. From the offering, 8,027,206 shares of unregistered common stock and 4,013,602 warrants were issued. The warrants were valued at \$1,779,172 using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.99%; the current stock price at date of issuance of \$2.70 per share; the exercise price of \$2.00; an expected term of five (5) years; volatility of 112%; and dividend yield of 0.0%.

The Warrants are exercisable for a period of five (5) years after the closing date at an exercise price of \$2.00 per share. Daybreak may call the warrants for redemption if (a) the average of the closing sale price of the common stock is at or above \$3.00 for twenty (20) out of thirty (30) trading days prior to the date the warrants are called, and (b) the warrant shares are registered under the Securities Act.

The Warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.99%; the current stock price at date of issuance of \$2.70 per share; the exercise price of the warrants; an expected term of five (5) years; volatility of 112%; and dividend yield of 0.0%. As of February 28, 2007, no subscriber warrants had been exercised.

Bathgate Capital Partners, of Denver, Colorado was the placement agent. Joseph Lavigne, son of Dale Lavigne (the Chairman and a director of Daybreak) is an employee of Bathgate Capital Partners. The Placement Agent was paid a sales commission of 10% of the gross proceeds of the private placement and a non-accountable expense allowance of 3% of the gross proceeds totaling \$790,402. Additionally, the Placement Agent was paid a due diligence fee of \$15,000. For every ten (10) units sold, the Placement Agent earned three (3) common stock warrants, two of which are exercisable at \$0.75 per share and one of which is exercisable at \$2.00 per share. The Placement Agent warrants are exercisable for a period of seven (7) years. The placement agent earned 1,204,082 warrants, of which 802,721 are exercisable at \$0.75 per share and were determined to have a fair value of \$2,043,752. The remaining 401,361 warrant shares are exercisable at \$2.00 per share and were determined to have a fair value of \$973,970. The placement agent warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.99%; the current stock price at date of issuance of \$2.70 per share; the exercise price of the warrants; an expected term of seven years; volatility of 112%; and dividend yield of 0.0%. As of February 28, 2007, no placement agent warrants had been exercised.

Both the subscriber warrants and the placement agent warrants have a cashless exercise provision and contain customary anti-dilution provisions. The cashless exercise provision allows for the holder of the warrants to receive a number shares equal to the quotient of a) the product of the number warrants held and the amount by which Daybreaks market traded stock price exceeds the exercise price of the warrants on the date of exercise, divided by b) the market traded stock price. The anti-dilution provisions permit the adjustment of the number of shares issuable upon exercise of the warrants in the event of stock splits, stock dividends, stock reversals and sales of substantially all of the Company's assets.

Daybreak agreed to register the shares on a "best efforts" basis. If Daybreak was unable to file the registration statement within the filing timeline, Daybreak would have had to issue 4,013,602 additional warrants at an exercise price of the lower of (a) the average closing sale price of its common stock for twenty of the thirty trading days immediately preceding the date the registration statement should have been filed, or (b) \$1.50 per common share. Daybreak did file the registration statement within the filing timeline. No additional warrants were required to be issued.

In February 2008, Daybreak issued "goodwill" common stock warrants to the participants of the Spring 2006 private placement. The warrants were issued as a goodwill gesture to investors in the two 2006 private placements due to the inability to complete the respective registration statements; recognizing, this was a result of regulatory process delays rather than any fault of the Company. Each participant was offered one "goodwill" warrant for every unit that had been purchased in exchange waiving their rights under the Registration Rights Agreement. On November 6, 2007, the date our Board approved issuing these "goodwill" warrants, the closing price of our stock was \$0.40.

As of February 29, 2008, we had received Registration Rights waiver letters from approximately 76% of the participants in this private placement. The warrants will expire on February 14, 2010, have an exercise price of \$0.65 and contain a cashless exercise provision. We have issued 2,998,934 goodwill warrants valued at \$680,238 to these investors. A total of 4,013,602 warrants could be issued. The issued warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 3.7 %; a term of two years; volatility of 121.67%; and dividend yield of 0.0%.

Daybreak evaluated the application of SFAS No. 133 and EITF 00-19 with respect to the conversion feature and the registration rights for consideration of embedded derivatives and concluded that the preferred stock and registration rights instruments did not have embedded derivatives.

The relative fair value of the Common Stock and the Common Stock Purchase Warrants was as follows:

Description	Shares	Relative Fair Value Amount
Common Stock	8,027,206	\$ 4,241,232
Common Stock Purchase Warrants	4,013,602	1,779,172
Total Proceeds		6,020,404
Placement fees		(832,147)
Net Proceeds		\$ 5,188,257

The trading prices of our common stock during the private placement period ranged from a low of \$ 1.66 per share to a high of \$ 2.80 per share. The proceeds from this offering were allocated to the following expenditures:

- Land acquisition;
- Drilling additional wells;
- Connecting well to pipeline;
- Seismic exploration;
- General and administrative expenses;
- Legal and accounting expenses.

This private placement offering was made pursuant to a Rule 506 exemption from registration promulgated under Regulation D of the Securities Act of 1933, as amended. All offerees and purchasers in this private placement were accredited investors.

- Commencing on July 7, 2006 and closing on July 18, 2006, we conducted a private placement of our Series A Convertible Preferred Stock. Bathgate Capital Partners LLC, of Denver, Colorado was the placement agent. We offered “units” for sale which were comprised of one share of our Series A Convertible Preferred stock and two common stock purchase warrants for \$3.00 per unit. Gross proceeds from the sale were \$4,199,291 which equated to 1,399,765 units. Our net proceeds were \$3,626,204 and the placement agent’s commission and other expenses equaled \$573,091.

A total of 100 investors participated in this private placement. From the offering, 1,399,765 shares of Series A Convertible Preferred stock and 2,799,527 common stock warrant shares were issued. Holders of Series A Convertible Preferred stock earn a dividend, in the amount of 6% of the original purchase price per year. Accumulated dividends do not bear interest. Dividends are payable upon declaration by the Board of Directors and none have been declared. The Series A Preferred can be converted by the shareholder at any time into three shares of Daybreak's common stock. If Daybreak's common stock is registered under the Securities Act of 1933, the Series A Preferred shall be automatically converted into common stock at any time after the effective date of the registration statement if Daybreak's common stock closes at or above \$3.00 per share for twenty (20) out of thirty trading days (30) days.

The Warrants included in the private placement, are exercisable for a period of five (5) years after the closing date at an exercise price of \$2.00 per share. In accordance with EITF 98-5, Daybreak valued the warrants and the beneficial conversion feature of the preferred stock. Accordingly, Daybreak recorded a discount for the warrants and beneficial conversion feature (BCF), of \$4,199,295. The discount is attributable to the fair value of the Warrants and the intrinsic value of the conversion feature of the preferred stock. The value of the BCF was recognized and measured separately by allocating to additional paid-in capital the proceeds equal to the \$1,489,222 relative fair value of the Warrants and the \$2,710,073 intrinsic value of the conversion feature. Daybreak also recorded a deemed dividend to reflect the full amortization of the discount of the value of the Warrants and conversion features of \$4,199,295. The fair value of each Warrant granted was estimated using the Black-Scholes pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.99%; the current stock price at date of issuance of \$2.20 per share; the exercise price of the warrants at \$1.00; an expected term of five years; volatility of 113%; and dividend yield of 0.0%. As of February 28, 2007, no warrants had been exercised.

Bathgate Capital Partners, of Denver, Colorado (Bathgate) was the placement agent. Joseph Lavigne, son of Dale Lavigne (the Chairman and a director of Daybreak) is an employee of Bathgate. Bathgate was paid a sales commission of 10% of the gross proceeds of the private placement and a non-accountable expense allowance of 3% of the gross proceeds totaling \$547,589. For every \$30.00 invested, Bathgate earned three (3) common stock purchase warrants exercisable at \$1.00 per share. The warrants are exercisable for a period of five (5) years. A total of 419,930 warrants were issued to Bathgate from this private placement and were valued at \$816,374. The placement agent warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.99%; the current stock price at date of issuance of \$2.20 per share; the exercise price of the warrants at \$1.00; an expected term of five years; volatility of 113%; and dividend yield of 0.0%. As of February 28, 2007, no placement agent warrants had been exercised.

Both the subscriber warrants and the placement agent warrants contain anti-dilution provisions. The anti-dilution provisions permit the adjustment of the number of shares issuable upon exercise of the warrants in the event of stock splits, stock dividends, stock reversals and sales of substantially all of the Company's assets. The placement agent warrants contain a cashless exercise provision.

The cashless exercise provision allows for the holder of the warrants to receive a number shares equal to the quotient of a) the product of the number warrants held and the amount by which Daybreaks market traded stock price exceeds the exercise price of the warrants on the date of exercise, divided by b) the market traded stock price.

Daybreak agreed to register the Series A Preferred shares on a “best efforts” basis. If Daybreak was unable to file the registration statement within the filing timeline, Daybreak would have to issue 1,399,765 additional warrants at an exercise price of \$2.00 per share. Daybreak was required to file the registration statement within sixty (60) days after the registration statement for the common stock private placement from the May of 2006 became effective. Daybreak did file the registration statement on time and no additional warrant issuances were required.

In February 2008, Daybreak issued “goodwill” common stock warrants to the participants of the July 2006 private placement. The warrants were issued as a goodwill gesture to investors in the two 2006 private placements due to the inability to complete the respective registration statement; recognizing, this was a result of regulatory process delays rather than any fault of the Company. Each participant was offered one “goodwill” warrant for every unit that had been purchased in exchange waiving their rights under the Registration Rights Agreement. On November 6, 2007, the date our Board approved issuing these “goodwill” warrants, the closing price of our stock was \$0.40. As of February 29, 2008, we had received Registration Rights waiver letters from approximately 79% of the participants in this private placement. The warrants will expire on February 14, 2010, have an exercise price of \$0.65 and contain a cashless exercise provision. We have issued 1,121,267 goodwill warrants valued at \$254,283 to these investors. A total of 1,399,765 warrants could be issued. The issued warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 3.7 %; a term of two years; volatility of 121.67%; and dividend yield of 0.0%.

Daybreak evaluated the application of SFAS No. 133 and EITF 00-19 with respect to the conversion feature and the registration rights for consideration of embedded derivatives and concluded that the preferred stock and registration rights instruments did not have embedded derivatives.

The relative fair values of the Series A Convertible Preferred Shares and the Common Stock Purchase Warrants were as follows:

Description	Shares	Relative Fair Value Amount
Series A Convertible Preferred	1,399,765	\$ 2,710,073
Common Stock Purchase Warrants	2,799,530	1,489,222
Total Proceeds		4,199,295
Offering Costs		(573,091)
Net Proceeds		\$ 3,626,204

The trading prices of the common stock during the private placement period ranged from a low of \$2.20 per share to a high of \$2.35 per share. The proceeds from this offering were allocated to the following expenditures:

Completions of wells;
Connecting wells to pipelines;
Drilling additional wells;
Working capital.

This offering was made pursuant to a Rule 506 exemption from registration promulgated under Regulation D of the Securities Act of 1933, as amended. All offerees and purchasers in this private placement were accredited investors.

From March 26, 2007 through February 29, 2008, ten (10) Series A Convertible Preferred shareholders, owning a total of 102,300 shares of our Series A Convertible Preferred Stock, from our July 2006 private placement, chose to convert their preferred shares to common stock. In accordance with the terms of the private placement agreement under which the preferred stock was purchased, each preferred share was converted to three shares of common stock resulting in 306,900 shares of common stock being issued.

- Commencing on October 19, 2007 and closing on December 28, 2007, we conducted an unregistered offering through a private placement of our common stock under the securities transaction exemption Regulation D Rule 506 of the Securities Act of 1933. Shares were offered at \$0.25 per share to “accredited investors” only as defined in Regulation D under the Securities Act of 1933. The shares were sold directly by Daybreak and no placement agent was involved in the offering. A total of 2,497,000 shares of unregistered common stock were sold to thirteen (13) investors resulting in \$624,250 in gross proceeds. Offering expenses were approximately \$6,500. Net proceeds were used to meet our drilling commitments in the Tuscaloosa project and general and administrative expenses.
- Commencing on January 2, 2008 we began conducting an unregistered offering through a private placement of our common stock under the securities transaction exemption Regulation D Rule 506 of the Securities Act of 1933. Shares are offered at \$0.25 per share to “accredited investors” only as defined in Regulation D under the Securities Act of 1933. The shares are being sold directly by Daybreak and also through a placement agent. As of February 29, 2008, a total of 605,000 shares of unregistered common stock have been sold to seven (7) investors resulting in \$151,250 in gross proceeds. The Placement Agent was paid a sales commission of 10% of the gross proceeds of their firm’s sales of the private placement and a non-accountable expense allowance of 3% of the gross proceeds of their firm’s sales totaling \$23,112.50. Net proceeds have been used to meet our drilling commitments in the Tuscaloosa project and general and administrative expenses.

Stock for Services

In accordance with the current interpretation of FAS 123(R) the value of the below listed transaction has been expensed as of the grant date of each transaction as reflected in our restated financial statements. The shares issued for services were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

On April 27, 2005, we issued 350,000 shares of unregistered common stock to AnMac Enterprises (a company owned by Michael McIntyre) for Investor Relations (“IR”) consulting services from March 1, 2005 through February 28, 2006. On the grant date of March 1, 2005, the closing price of our stock was \$0.79. Based on the closing price the value of this stock issuance was \$276,500.

On April 27, 2005, we issued 500,000 shares of unregistered common stock to Eric L. Moe (appointed Chief Executive Officer in March 2006; resigned as Chief Executive Officer and director in December 2007) for Investor Relations (“IR”) consulting services from March 1, 2005 through February 28, 2006. On the grant date of March 1, 2005, the closing price of our stock was \$0.79. Based on the closing price the value of this stock issuance was \$395,000.

On May 11, 2005, we issued 1,100,000 shares of unregistered common stock to 413294 Alberta, Ltd., of Calgary, Alberta to supply the services of Robert N. Martin, as our Company President (resigned as President and director December 2007). On the grant date of March 1, 2005, the closing price of our stock was \$0.79. Based on the price the value of this stock issuance was \$869,000.

On May 25, 2005, we issued 300,000 shares of unregistered common stock to Irwin Renneisen for IR consulting services. On the grant date of May 18, 2005, the closing price of our stock was \$0.38. Based on the closing price the value of this stock issuance was \$114,000. In August 2005, the 300,000 shares were voided and returned on August 25, 2005, and we then issued Irwin Renneisen 30,000 shares of restricted common stock. On the revised grant date of August 25, 2005, the closing price of our stock was \$0.44. Based on the closing price the value of this stock issuance was \$13,200.

On October 5, 2005, we issued 1,000,000 shares of unregistered common stock to Eric L. Moe (appointed Chief Executive Officer in March 2006; resigned as Chief Executive Officer and director in December 2007) for IR consulting services. On the grant date of September 27, 2005, the closing price of our stock was \$0.56. Based on the closing price the value of this stock issuance was \$560,000.

On October 27, 2005, we issued 1,667 shares of unregistered common stock to Laura Crist as partial payment for marketing services for our web site.

On October 27, 2005, we issued 10,000 shares of unregistered common stock to Gregory Lipsker as payment for legal services.

On November 30, 2005, we issued 400,000 shares of unregistered common stock to Terrence J. Dunne, (appointed a director in January 2006 and Chief Financial Officer in April 2006; resigned as Chief Financial Officer and director in December 2007), a shareholder and 10% control person (at the time), for management services. On the grant date of September 27, 2005, the closing price of our stock was \$0.56. Based on the closing price the value of this stock issuance was \$224,000.

On January 17, 2006, we issued 300,000 shares of unregistered common stock to Dale B. Lavigne (Chairman), for management services. On the grant date of September 27, 2005, the closing price of our stock was \$0.56. Based on the closing price the value of this stock issuance was \$168,000.

On January 17, 2006, we issued 300,000 shares of unregistered common stock to Ronald D. Lavigne (director) for management services. On the grant date of September 27, 2005, the closing price of our stock was \$0.56. Based on the closing price the value of this stock issuance was \$168,000.

On January 17, 2006, we issued 400,000 shares of unregistered common stock to Thomas C. Kilbourne (Treasurer and director; resigned in December 2007) for management services. On the grant date of September 27, 2005, the closing price of our stock was \$0.56. Based on the closing price the value of this stock issuance was \$224,000.

On January 17, 2006, we issued 600,000 shares of unregistered common stock to Kirby Cochran, a shareholder for IR consulting services. On the grant date of January 13, 2006, the closing price of our stock was \$0.55. Based on the closing price the value of this stock issuance was \$330,000.

On February 17, 2006, we issued 100,000 shares of unregistered common stock to Bennett W. Anderson, a shareholder for consulting services. On the grant date of February 17, 2006, the closing price of our stock was \$2.23. Based on the closing price the value of this stock issuance was \$223,000.

On May 3, 2006, we issued 70,000 shares of unregistered common stock to Gregory Donelson for consulting services. On the grant date of December 14, 2005, the closing price of our stock was \$0.61. Based on the closing price the value of this stock issuance was \$42,700.

On May 10, 2006, we issued 150,000 shares of unregistered common stock to AnMac Enterprises (a company owned by Michael McIntyre) for Investor Relations ("IR") consulting work from March 1, 2006 through February 28, 2007. On the grant date of March 1, 2006, the closing price of our stock was \$2.39. Based on the closing price the value of this stock issuance was \$358,500.

On May 26, 2006, we issued 250,000 shares of unregistered common stock to 413294 Alberta, Ltd., of Calgary, Alberta to supply the services of Robert N. Martin, as our Company President (resigned as President and director December 2007). On the grant date of March 1, 2006, the closing price of our stock was \$2.39. Based on the closing price the value of this stock issuance was \$597,500.

On May 26, 2006, we issued 250,000 shares of unregistered common stock to Eric L. Moe, Chief Executive Officer (resigned as Chief Executive Officer and director in December 2007), for management services from March 1, 2006 through February 28, 2007. On the grant date of March 1, 2006, the closing price of our stock was \$2.39. Based on the closing price the value of this stock issuance was \$597,500.

On May 26, 2006, we issued 100,000 shares of unregistered common stock to Thomas C. Kilbourne, (Treasurer and a director; resigned in December 2007) for management services from March 1, 2006 through February 28, 2007. On the grant date of March 1, 2006, the closing price of our stock was \$2.39. Based on the closing price the value of this stock issuance was \$239,000.

On August 31, 2006, we issued another 250,000 shares of unregistered common stock to Eric L. Moe, (Chief Executive Officer and a director; resigned as Chief Executive Officer and director in December 2007). The shares were issued as additional compensation. On the grant date of August 3, 2006, the closing price of our stock was \$2.05. Based on the closing price the value of this stock issuance was \$512,500.

On February 23, 2007, we issued 200,000 shares of unregistered common stock to Timothy R. Lindsey, (a director; appointed interim President and Chief Executive Officer in December 2007) for consulting services from January 2, 2007, through February 28, 2008. On the grant date of January 2, 2007, the closing price of our stock was \$1.30. Based on the closing price the value of this stock issuance was \$260,000.

On August 17, 2007, we issued 10,000 shares of unregistered common stock to Frank Duval, a shareholder for consulting services. On the grant date of August 17, 2007, the closing price of our stock was \$0.45. Based on the closing price the value of this stock issuance was \$4,500.

Stock for Directors Services

In accordance with the current interpretation of FAS 123(R) the value of the below listed transaction has been expensed as of the grant date of each transaction as reflected in our restated financial statements. The shares issued for services were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

On November 30, 2005, we issued 18,000 shares of unregistered common stock to each of the six members of the Board of Directors. These directors were 413295 Alberta Ltd. (Robert N. Martin), Michael Curtis, Dale B. Lavigne, Jeffrey R. Dworkin, Ronald D. Lavigne and Thomas C. Kilbourne. On the grant date of October 25, 2005, the closing price of our stock was \$0.55. Based on the closing price the value of each stock issuance was \$9,900.

On November 30, 2005, we issued 9,000 shares of unregistered common stock worth to each of the six members of the Board of Directors for director's fees for the third quarter of the current fiscal year. These directors were 413295 Alberta Ltd. (Robert N. Martin), Michael Curtis, Dale B. Lavigne, Jeffrey R. Dworkin, Ronald D. Lavigne and Thomas C. Kilbourne. On the grant date of November 30, 2005, the closing price of our stock was \$0.52. Based on the closing price the value of each stock issuance was \$4,680.

On February 28, 2006, we issued 3,000 shares of unregistered common stock worth to each of the seven members of the Board of Directors for director's fees for the fourth quarter of the current fiscal year. These directors were 413295 Alberta Ltd. (Robert N. Martin), Michael Curtis, Dale B. Lavigne, Jeffrey R. Dworkin, Ronald D. Lavigne, Terrence J. Dunne and Thomas C. Kilbourne. On the grant date of February 28, 2006, the closing price of our stock was \$2.25. Based on the closing price the value of each stock issuance was \$6,750.

Stock for Oil and Gas Properties

In accordance with the current interpretation of FAS 123(R) the value of the below listed transaction has been expensed as of the grant date of each transaction as reflected in our restated financial statements. The shares issued for services were issued pursuant to a Section 4(2) exemption from registration under the Securities Act of 1933, as amended.

On August 31, 2005, we issued 100,000 shares of unregistered common stock to Margaret Perales of MPG Petroleum as consideration for participation in the Pearl Prospect located in Texas. On the grant date of August 31, 2005, the closing price of our stock was \$0.37. Based on the closing price the value of this stock issuance was \$37,000.

On October 27, 2005, we issued 600,000 shares of unregistered common stock to Sam Pfister, Trustee for the Chicago Mill Joint Venture ("CMJV") in the Tuscaloosa project in Louisiana. On the grant date of September 29, 2005, the closing price of our stock was \$0.63. Based on the closing price the value of this stock issuance was \$378,000.

On May 31, 2006, we issued 150,000 shares of unregistered common stock to Big Sky Western Canada of Calgary, Alberta, Canada as consideration for our participation in the 40 Mile Coulee project in Alberta, Canada. On the grant date of May 30, 2006, the closing price of our stock was \$2.80. Based on the closing price the value of this stock issuance was \$420,000. On December 8, 2006, we repurchased the original 150,000 shares from Big Sky Western Canada for the original book value of \$1.00 per share as part of the settlement of the plug and abandonment negotiations on the 40 Mile Coulee project. The shares were consequently cancelled.

On September 22, 2006, we issued 72,500 shares of unregistered common stock to Strike Oil & Minerals, Corp., as part of our purchase of an additional eight percent (8%) working interest in the Tuscaloosa project in Louisiana. On the grant date of September 22, 2006, the closing price of our stock was \$1.50. Based on the closing price the value of this stock issuance was \$108,750.

Common Stock Warrants

In February 2008, Daybreak issued "goodwill" common stock warrants to the participants of the two private placement offerings that were held during 2006. These warrants have been previously described in the preceding private placement information of this 10-KSB annual report. The warrants were issued as a goodwill gesture to investors in the private placements due to the inability to complete the respective registration statements; recognizing, this was a result of regulatory process delays rather than any fault of the Company. Each participant from both private placements was offered one "goodwill" warrant for every unit that had been purchased in exchange waiving their rights under the Registration Rights Agreement. On November 6, 2007, the date our Board approved issuing these "goodwill" warrants, the closing price of our stock was \$0.40. As of February 29, 2008, we had received acceptance letters from approximately 77% of the participants in these two private placements. The warrants will expire on February 14, 2010, have an exercise price of \$0.65 and contain a cashless exercise provision. We have issued 4,120,201 goodwill warrants valued at \$934,521 to these investors. A total of 5,413,367 warrants could be issued. The issued warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 3.7%; a term of two years; volatility of 121.67%; and dividend yield of 0.0%.

Securities Authorized for Issuance under Equity Compensation Plan

We have no agreements with any employees or consultants for issuing options, warrants or rights on our stock. We have however, issued unregistered restricted common stock in the past as a part of our employment and consulting contracts. These instances are explained in the detail immediately above.

Common Stock

The Company is authorized to issue 200,000,000 shares of Common Stock with a par value of \$0.001 of which 40,877,230 were issued as of February 28, 2007. At February 29, 2008, a total of 44,293,299 shares were issued and outstanding. All shares of Common Stock are equal to each other with respect to voting, liquidation, dividend and other rights.

Owners of shares of Common Stock are entitled to one vote for each share of Common Stock owned at any shareholders' meeting. Holders of shares of Common Stock are entitled to receive such dividends as may be declared by the Board of Directors out of funds legally available therefore; and upon liquidation, are entitled to participate pro rata in a distribution of assets available for such a distribution to shareholders.

There are no conversion, preemptive, or other subscription rights or privileges with respect to any shares of our Common Stock. Our stock does not have cumulative voting rights, which means that the holders of more than fifty percent (50%) of the shares voting in an election of directors may elect all of the directors if they choose to do so. In such event, the holders of the remaining shares aggregating less than fifty percent (50%) would not be able to elect any directors.

Preferred Stock

The Company is authorized to issue 10,000,000 shares of Preferred Stock with a par value of \$0.001 of which none had been issued as of February 28, 2006. Our Preferred Stock may be entitled to preference over the Common Stock with respect to the distribution of assets of the Company in the event of liquidation, dissolution, or winding-up of the Company, whether voluntarily or involuntarily, or in the event of any other distribution of assets of the Company among its shareholders for the purpose of winding-up its affairs. The authorized but unissued shares of Preferred Stock may be divided into and issued in designated series from time to time by one or more resolutions adopted by the Board of Directors. The directors in their sole discretion shall have the power to determine the relative powers, preferences, and rights of each series of Preferred Stock.

On June 30, 2006, in action by the Board of Directors, 2,400,000 of these preferred shares were designated as Series A Convertible Preferred. In July 2006, we completed a private placement of the Series A Convertible Preferred that resulted in the issuance of 1,399,765 shares. At February 29, 2008, there were 1,297,465 shares issued and outstanding. There were a total of 102,300 shares that were converted to our common stock during the fiscal year.

Series A Convertible Preferred Stock

The following is a summary of the rights and preferences of the Series A Convertible Preferred Stock

Conversion:

The preferred shareholder shall have the right to convert the Series A Convertible Preferred Stock into the Company's Common Stock at any time. Each share of Preferred Stock is convertible into three (3) shares of Common Stock.

Automatic Conversion:

The Series A Convertible Preferred Stock shall be automatically converted into Common Stock if the Common Stock into which the Series A Convertible Preferred Stock are convertible are registered with the Securities and Exchange Commission and at any time after the effective date of the registration statement the Company's Common Stock closes at or above \$3.00 per share for twenty (20) out of thirty trading days (30) days.

Dividend:

Holders of Series A Convertible Preferred Stock shall be paid dividends, in the amount of 6% of the Original Purchase price per annum. Dividends may be paid in cash or Common Stock at the discretion of the Company. Dividends are cumulative from the date of the Final Closing, whether or not in any dividend period or periods we have assets legally available for the payment of such dividends. Accumulations of dividends on shares of Series A Convertible Preferred Stock do not bear interest. Dividends are payable upon declaration by the Board of Directors.

Voting Rights:

The holders of the Series A Convertible Preferred Stock will vote together with the common stock and not as a separate class except as specifically provided herein or as otherwise required by law. Each share of the Series A Convertible Preferred Stock shall have a number of votes equal to the number of shares of Common Stock then issuable upon conversion of such shares of Series A Convertible Preferred Stock.

Debt Securities

From March 23, 2005 through August 31, 2005, in a series of twenty-seven loans, we borrowed from six officers, directors or shareholders, a total of \$168,821 to finance ongoing operations. These convertible debentures were for a term of one year; had a 6% interest rate and both the principal and interest could be converted to unregistered common stock after a minimum period of six months. The conversion rate was \$0.25 per share. During the fiscal year ended February 28, 2006, twenty-four of the twenty-seven loans were converted to unregistered common stock resulting in 566,134 unregistered shares being issued. During the fiscal year ended February 28, 2007, the remaining three convertible debentures were converted to unregistered common stock resulting in 137,541 unregistered shares being issued.

From January 25, 2006 through February 8, 2006, in a series of eight loans, we borrowed from seven shareholders a total of \$806,700 to finance ongoing operations. These convertible debentures were for a term of one year; had a 10% interest rate and both the principal and interest could be converted to unregistered common stock after a minimum period of sixty-one days. The conversion rate was \$0.50 per share. During the fiscal year ended February 28, 2007, all eight loans were converted to unregistered common stock resulting in 468,592 unregistered shares being issued.

From February 24, 2006 through March 6, 2006, in a series of four loans, we borrowed from four existing shareholders a total of \$325,001 to finance ongoing operations. These loans were in the form of convertible debentures (3) and a loan agreement with the following features. The term was for a period of one year; the interest rate was 10%; the notes could be converted to our common stock after a holding period of 61 days; and the conversion rate is \$0.75 per share. The loan agreement balance of \$100,000 plus interest was converted to unregistered common stock on June 6, 2006. In December 2006, all three convertible debenture holders agreed to extend the term of the notes to August 31, 2007. This agreement for the term extension did not affect the debenture holders rights to convert to common stock at any time. We issued 150,001 warrants to these debenture holders as consideration for extending the term of the notes. The fair market value of these warrants was \$119,283. On April 30, 2007, one debenture holder chose to convert his note to unregistered common stock. He was issued 37,169 shares of stock from this conversion. On August 31, 2007, the remaining two convertible debenture holders agreed to extend the term of the debentures to October 31, 2007. We issued 112,000 warrants to these debenture holders as consideration for extending the term of the notes. The warrants were valued at \$35,386 using the Black-Scholes option pricing model.

The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.1 %; the current stock price at date of issuance of \$0.53 per share; the exercise price of the warrants of \$0.53; the term of two years; volatility of 114%; and dividend yield of 0.0%.

On October 31, 2007, one of the two remaining convertible debenture holders chose to receive a payoff of \$76,756.87 representing the principal plus accumulated interest of the convertible debenture. The other convertible debenture holder agreed to extend the term of his debenture until January 31, 2008. In consideration of the term extension he received 90,000 warrants. The warrants were valued at \$25,587 using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 3.9 %; the current stock price at date of issuance of \$0.40 per share; the exercise price of the warrants of \$0.25; the term of two years; volatility of 121.64%; and dividend yield of 0.0%. The value of the warrants was recognized at the time of issuance as a discount against the existing convertible debentures and was amortized using the effective interest method until maturity.

On January 31, 2008, the remaining convertible debenture holder received a payoff of \$128,151.71 representing the principal plus accumulated interest of the convertible debenture.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following management's discussion and analysis ("MD&A") is management's assessment of the historical financial and operating results of Daybreak Oil and Gas, Inc. ("Daybreak", the "Company", "we", "us" or "our") during the period covered by the financial statements. This MD&A should be read in conjunction with the audited financial statements and the related notes and other information included elsewhere in this 10-KSB report.

Additional information relating to Daybreak is available on EDGAR at www.edgar-online.com or our web site at www.daybreakoilandgas.com. Our stock is quoted on the NASDAQ over the counter (OTC.BB) market under the symbol DBRM.OB.

Safe Harbor Provision

Certain statements contained in our Management's Discussion and Analysis of Financial Condition or Plan of Operation 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 Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts contained in this report, including statements regarding our current expectations and projections about future results, business strategy, performance, prospects and opportunities, are forward-looking statements. To understand about forward looking statements, please refer the section labeled forward looking statements at the beginning of this 10-KSB report.

Plan of Operation

As an early stage oil and gas exploration and development company our expenditures consist primarily of geological and engineering services, acquiring mineral leases, exploration and drilling costs and travel. Our expenses also consist of consulting and professional services, employee compensation, legal and accounting and general and administrative expenses which we have incurred in order to address necessary organizational activities.

Our longer-term success depends on, among many other factors, the acquisition and drilling of commercial grade oil and gas properties and on the prevailing sales prices for oil and natural gas along with associated operating expenses. Oil and natural gas prices have been extremely volatile in recent years and are affected by many factors outside our control. This volatile nature of the energy markets makes it difficult to estimate future prices of oil and natural gas; however, any prolonged period of depressed prices would have a material adverse effect on our results of operations and financial condition.

Our operations are focused on identifying and evaluating prospective oil and gas properties and funding projects that we believe have the potential to produce oil or gas in commercial quantities. We are currently developing projects in Alabama, California, Louisiana and Texas. In November 2006, we became the operator of the Tuscaloosa project in Tensas and Franklin Parishes in Louisiana. In January 2007, drilling began in Louisiana on the Krotz Springs project. We were the operator of record during the drilling and completion phases of this project. In Alabama, we have been operator of the East Gilbertown Field since June 2007. During the past three fiscal years, we have been involved in the drilling of ten wells in Louisiana, Texas and Alberta, Canada. We have achieved commercial production in four of these projects. Additionally, we have participated in eighteen workover projects in Alabama and Texas and have achieved or increased commercial production in fifteen of the wellbores.

Selected Financial Information

Since our inception, we have incurred recurring losses from operations with negative cash flow and have depended on external financing to sustain our operations. During the fiscal year ended February 29, 2008, we reported losses of \$5,200,694. There is no assurance that we will be able to achieve profitability.

Our balance sheet on February 29, 2008, shows total assets of \$3,661,037 comprised primarily of oil and gas properties (net of Depreciation, Depletion, Amortization and Impairment) of \$169,521, accounts receivable (including trade, related parties and joint interest participants) of \$813,697, assets held for sale of \$1,634,471 and cash and marketable securities for \$214,578. This compares with the February 28, 2007 balances for oil and gas properties of \$1,054,029; cash and marketable securities for \$2,734,170 and notes receivable and accounts receivable of \$1,726,569.

At February 29, 2008, we had total liabilities of \$435,460, comprised of \$316,253 in accounts payable and \$119,207 in asset retirement obligation (ARO) as compared with the February 28, 2007 balances for accounts payable of \$2,110,458, notes payable (net of discount) of \$334,999 and ARO of \$99,427.

Our common stock issued and outstanding has increased by 3,416,069 shares during the last fiscal year primarily as a result of private placement sales and conversions from our Series A Convertible Preferred stock. Preferred stock decreased by 102,299 shares to 1,297,465 at February 29, 2008, compared to 1,399,765 at February 28, 2007, as a result of conversions to our common stock.

Accumulated Deficit

The increase in the accumulated deficit during the exploration stage from \$12,864,071 at February 28, 2007, to \$18,064,765 was due to the \$5,200,694 operating loss from the fiscal year ended February 29, 2008. This was the smallest net loss we have experienced since becoming an oil and gas exploration and development company.

Cash Flows

Cash flow from operating activities for the fiscal year ended February 29, 2008, was \$(1,302,213) compared to (\$3,427,627) for the period ending February 28, 2007. This negative flow was primarily caused by the net loss (\$5,200,694 in comparison to \$8,392,030 from the prior year); larger amount of accounts receivable from oil and gas sales (\$311,277 in comparison to \$56,906) being offset by less common stock being issued for services (\$4,500 in comparison to \$2,607,700 in the prior year); less exploration expense from dry holes (33,233 in comparison to \$563,020); lower non-cash interest expense and accretion (\$164,873 in comparison to \$1,209,529) as well as marketable securities \$2,200,768 in comparison to (\$2,356,213)). Cash flows from accounts receivable – joint interest participants declined (\$702,450 in comparison to \$799,970) as well as accounts payable and accrued liabilities (\$(1,385,367) in comparison to \$1,604,626).

Cash flow from investing activities for the fiscal year ended February 29, 2008, was a positive \$576,574 compared to (\$6,039,904) for the same period ending February 28, 2007.

This difference was due to a smaller decrease oil and gas properties (\$2,036,888) in comparison to \$5,441,993 from the prior year) and the receipt of \$2 million for the sale of 25% of the working interest in the Tuscaloosa Project as well as the payoff of the note receivable from the refurbishment of the drilling rig.

Cash flow from financing activities for the fiscal year ended February 29, 2008, was \$406,815 compared to \$9,039,461 for the same period ending February 28, 2007. This difference was due to less common stock and no preferred stock being sold compared to the prior year (\$731,816 in comparison to \$8,814,461). This difference was offset by the repayment of convertible debentures (\$325,001 in comparison to \$25,000).

Liquidity and Capital Resources

Liquidity and Working Capital

Liquidity is defined as the ability to convert assets into cash or to obtain cash. Short-term liquidity refers to the ability to meet short-term obligations of 12 months or less. Liquidity is a matter of degree and is expressed in terms of a ratio. Two common liquidity ratios in financial statement analysis are: Working Capital and Current Ratio.

Our working capital (current assets minus current liabilities) and current ratio (current assets divided by current liabilities) are as follows:

	February 29, 2008	February 28, 2007
Current Assets	\$ 1,049,217	\$ 4,537,634
Current Liabilities	\$ 316,253	\$ 2,445,457
Working Capital	\$ 732,964	\$ 2,092,177
Current Ratio	3.32	1.86

While these two ratios are important, numerous other factors may also affect the liquidity and capital resources of a company. Our working capital decreased from \$2,092,177 as of February 28, 2007, to \$732,964 as of February 29, 2008. This decrease was principally due to the aggressive stance we took to pay off payables and debt as shown in a decrease of \$2,129,204 in accounts payable, notes payable and convertible debentures that we had issued during the last two fiscal years to meet operating expenses as well as having used cash on hand to meet operating expenses and the payoff of the note receivable on the refurbishment of the drilling rig.

Our business is capital intensive. Our ability to grow is dependent upon our ability to obtain outside capital and generate cash flows from operating activities to necessary to fund our investment activities. As of February 29, 2008, we have not yet demonstrated the ability to generate significant and sustainable cash flow from producing wells developed as a result of our prior exploration and development activities. This is especially true of our Tuscaloosa project and was a major reason we decided to accept an offer to sell our working interest in the Tuscaloosa project for \$8 million.

Our sources of funds in the past have included the debt or equity markets and while we have had cash flow from operations, we have not yet established sustainable positive cash flow from those operations. We may again have to rely on the debt or equity markets to fund future operations. Our business model is focused on acquiring exploration or development properties and also acquiring existing producing properties. Our ability to generate future revenues and operating cash flow will depend on successful exploration, and/or acquisition of oil and gas producing properties, which may very likely require us to continue to raise equity or debt capital from outside sources. We have ongoing capital commitments to develop certain leases pursuant to their underlying terms. Failure to meet such ongoing commitments may result in the loss of certain leases. These ongoing capital commitments may also cause us to seek additional capital from outside sources.

Since our inception, we have incurred recurring start-up losses from operations with negative cash flow and we have depended on external financing to sustain our operations. During the fiscal year ended February 29, 2008, we reported losses of \$4.27 million. 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 exterior sources, should we be unable to achieve sustainable profitability this could cause any equity investment in the Company to become worthless. The final closing of \$5.5 million on the sale of our Tuscaloosa project will allow us to move forward with our exploration and drilling projects in California.

Critical Accounting Policies

Management's discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, bad debts, cancellation costs associated with long term commitments, investments, intangible assets, assets subject to disposal, income taxes, service contracts, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making estimates and judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ from those estimates and could have a material impact on our financial statements, and it is possible that such changes could occur in the near term.

Oil and Gas Properties

We use the successful efforts method of accounting for oil and gas property acquisition, exploration, development, and production activities. Costs to acquire mineral interests in oil and gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip developmental wells are capitalized as incurred. Costs to drill exploratory wells that are unsuccessful in finding proved reserves are expensed as incurred. In addition, the geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed as incurred. Costs to operate and maintain wells and field equipment are expensed as incurred.

Capitalized proved property acquisition costs are amortized by field using the unit-of-production method based on proved reserves. Capitalized exploration well costs and development costs (plus estimated future dismantlement, surface restoration, and property abandonment costs, net of equipment salvage values) are amortized in a similar fashion (by field) based on their proved developed reserves. Support equipment and other property and equipment are depreciated over their estimated useful lives.

Pursuant to SFAS No. 144, "Impairment or Disposal of Long-Lived Assets", we review proved oil and natural gas properties and other long-lived assets for impairment. These reviews are predicated by events and circumstances, (such as downward revision of the reserve estimates or commodity prices), that indicate a decline in the recoverability of the carrying value of such properties. We estimate the future cash flows expected in connection with the properties and compare such future cash flows to the carrying amount of the properties to determine if the carrying amount is recoverable. When the carrying amounts of the properties exceed their estimated undiscounted future cash flows, the carrying amounts of the properties are reduced to their estimated fair value. The factors used to determine fair value include, but are not limited to, estimates of proved reserves, future commodity prices, the timing of future production, future capital expenditures and a risk-adjusted discount rate. The charge is included in depreciation, depletion and amortization.

Unproved oil and gas properties that are individually significant are also periodically assessed for impairment of value. An impairment loss for unproved oil and gas properties is recognized at the time of impairment by providing an impairment allowance.

On the retirement or sale of a partial unit of proved property, the cost is charged to accumulated depreciation, depletion, and amortization with a resulting gain or loss recognized in income.

Deposits and advances for services expected to be provided for exploration and development or for the acquisition of oil and gas properties are classified as long term other assets.

Revenue Recognition

We use the sales method to account for sales of crude oil and natural gas. Under this method, revenues are recognized based on actual volumes of oil and gas sold to purchasers. The volumes sold may differ from the volumes to which we are entitled based on its interests in the properties. These differences create imbalances, which are recognized as a liability only when the imbalance exceeds the estimate of remaining reserves. We had no significant imbalances as of February 29, 2008 and February 28, 2007.

Suspended Well Costs

On April 4, 2005, the Financial Accounting Standards Board, (FASB) issued FASB Staff Position No. 19-1, "Accounting for Suspended Well Costs" (FSP No. 19-1). This staff position amends SFAS No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies" and provides guidance concerning exploratory well costs for companies that use the successful efforts method of accounting. Daybreak adopted FSP No. 19-1 for the fiscal years ended February 29, 2008 and February 28, 2007.

The FSP states that exploratory well costs should continue to be capitalized if: (1) a sufficient quantity of reserves are discovered in the well to justify its completion as a producing well and (2) sufficient progress is made in assessing the reserves and the economic and operating feasibility of the well. If the exploratory well costs do not meet both of these criteria, these costs should be expensed, net of any salvage value. Additional annual disclosures are required to provide information about management's evaluation of capitalized exploratory well costs.

In addition, the FSP requires annual disclosure of: (1) net changes from period to period of capitalized exploratory well costs for wells that are pending the determination of proved reserves, (2) the amount of exploratory well costs that have been capitalized for a period greater than one year after the completion of drilling and (3) an aging of exploratory well costs suspended for greater than one year, designating the number of wells the aging is related to. Further, the disclosures should describe the activities undertaken to evaluate the reserves and the projects, the information still required to classify the associated reserves as proved and the estimated timing for completing the evaluation.

Share Based Payments

Prior to February 28, 2005, we accounted for our stock based compensation plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations, ("APB 25") as permitted by SFAS No. 123, "Accounting for Stock Based Compensation" ("SFAS 123").

Effective March 1, 2005, we adopted the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") for our stock based compensation plans under the recognition and measurement provisions of SFAS 123. No awards granted prior to March 1, 2005 were modified or settled in cash during fiscal year ended February 28, 2006.

Effective March 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123R, "Share Based Payment" and related Interpretations ("SFAS 123R").

Under both SFAS 123 and SFAS 123R, compensation cost for all share based payments granted on or subsequent to March 1, 2005 are based on the grant date fair value estimated in accordance with the provisions of SFAS 123 and SFAS 123R, for the respective fiscal years. Compensation cost is recognized on a straight line basis over the requisite service period for the entire award in accordance with the provisions of SFAS 123R. If at any date the portion of the grant-date fair value of the award that is vested is greater than that amount recognized on a straight line basis, the amount of the vested grant date fair value is recognized.

We account for transactions in which we issue equity instruments to acquire goods or services from non-employees in accordance with the provisions of SFAS No. 123R (as amended). These transactions are accounted for based on the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable.

Fiscal Year 2008 compared to Fiscal Year 2007 – Continuing Operations

This discussion comparing fiscal year 2008 results with fiscal year 2007 results covers our continuing operations in Gilberttown Field in Alabama, Krotz Springs in Louisiana and Saxet Field in Texas.

Revenues. Our revenues are derived entirely from the sale of our share of oil and gas production from our producing wells. We realized our first revenues from producing wells in August 2006. Prior to that date, we had no revenues from continuing operations.

A table of our revenues for the fiscal year 2008 compared to the fiscal year 2007 follows:

	Fiscal Year 2008	Fiscal Year 2007
Alabama - Gilberttown	\$ 119,209	\$ 2,110
Louisiana – Krotz Springs	74,740	-
Texas - Saxet Field	172,901	152,678
Total Revenues	\$ 366,850	\$ 154,788

The Gilberttown Field in Alabama revenues represented 32.5% of total revenues. The Krotz Springs project in Louisiana began commercial production in May 2007. The Krotz Springs revenues represented 20.4% of total revenues. The Saxet Field in Texas revenues represented 47.1% of total revenues. For the fiscal year ended February 29, 2008, total revenues increased 237% from the prior fiscal year.

We recorded revenues from our interests in twenty (20) producing wells.

Costs and Expenses: Total operating expenses declined by 21.7% or \$1,660,625 for the fiscal year ended February 29, 2008 as compared to the prior fiscal year. The largest decreases of 32.3% or \$1,273,191 and 45.3% or \$541,875 were in our general and administrative (“G&A”) and exploration and drilling costs respectively.

A table of our costs and expenses for the fiscal year 2008 compared to the fiscal year 2007 follows:

	Fiscal Year 2008	Fiscal Year 2007
Production Costs	\$ 326,849	\$ 107,931
Exploration Costs	654,765	1,196,640
Depreciation, Depletion, Amortization & Impairment	2,333,571	2,398,048
General & Administrative	2,663,677	3,936,868
Total Operating Expenses	\$ 5,978,862	\$ 7,639,487

Expenses incurred by the Company include production costs associated directly with the generation of oil and gas revenues and well workover projects, general and administrative expenses, including legal and accounting expenses, director and management fees, investor relations expenses, and other general and administrative costs, and unsuccessful exploration costs.

Production costs increased \$218,918 or 302% from the prior fiscal year and relate directly to the existence of new production revenues from the Gilberttown Field and the Krotz Springs well and the increased production costs in the Saxet Field in fiscal year ended February 29, 2008.

Exploration expenses decreased \$541,875 or 45.3% from the prior fiscal year. The majority of this change was from decreased dry hole expenses in comparison to the prior fiscal year. For the fiscal year ended February 29, 2008 we participated in the drilling of one dry hole.

Depreciation, depletion, amortization and impairment expenses had decreased \$64,477 or 2.7% from the prior fiscal year.

General and administrative costs decreased \$1,273,191 or 32.3% from the prior fiscal year. Management fees and Investor Relations fees accounted for the two largest decreases in the expenses declining by \$1,538,594 or 47.4% from the prior fiscal year.

Legal and accounting fees, another part of general and administrative costs, increased \$151,287 or 54.3% from the prior fiscal year. This was a direct result of our having to restate our financial statements for the fiscal year ended February 28, 2006 and the first three quarters of the fiscal year ended February 28, 2007.

Interest and dividend income decreased \$60,003 or 56% from the prior fiscal year due primarily to lower average cash and investment balances.

Interest expense decreased by \$1,014,407 or 83% from the prior fiscal year. This was a result of an aggressive program to pay off existing debt.

Due to the nature of its business, as well as the relative immaturity of the business, we expect that revenues, as well as all categories of expenses, will continue to fluctuate substantially quarter to quarter and year to year. Production costs will fluctuate according to the number and percentage ownership of producing wells, as well as the amount of revenues being contributed by such wells. Exploration and drilling expenses will be dependant 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 depreciation, depletion, amortization expense and impairment costs will depend upon the factors cited in the prior sentence, as well as numerous other factors including general market conditions.

Fiscal Year 2008 compared to Fiscal Year 2007 – Discontinued Operations

On January 18, 2008 we signed a purchase and sale agreement (“PSA”) for the sale of our Tuscaloosa project interests for \$8 million dollars. The transaction closed in three tranches; the first closing of \$2 million occurred on January 18, 2008; the second closing for \$500,000 occurred on April 30, 2008; and the final closing for \$5.5 million occurred on June 12, 2008 and was subject to customary closing adjustments. The sale includes Daybreak’s interests in the Tensas Farms et al F-1, F-3, B-1, A-1 and F-2 wells; and all of its acreage and infrastructure in the project area. Under terms of the PSA, the effective dates for each closing was January 1, 2008.

Revenues. The revenues shown are from oil and gas production of the Tensas Farms et al F-1, F-3 and A-1 wells. We realized our first revenues from the F-1 in June 2006; the F-3 in February 2007; and the A-1 in December 2007.

A table of our revenues for the fiscal year 2008 compared to the fiscal year 2007 follows:

	Fiscal Year 2008	Fiscal Year 2007
Tensas Farms F-1	\$ 59,333	\$ 472,526
Tensas Farms F-3	383,211	2,032
Tensas Farms A-1	208,210	-
Total Revenues	\$ 650,754	\$ 474,558

Income from discontinued operations, representing our Tuscaloosa Project interest increased by \$176,196 or 37.1%. This increase was primarily due to the Tensas Farms A-1 well coming into production in December 2007.

The F-1 returned to production in January 2008 after being shut-in since November 2006, and represents 9.1% of Tuscaloosa revenues. The F-3 commenced production in February 2007, and represents 58.9% of Tuscaloosa revenues. The A-1 well commenced production in December 2007, and represents 32% of Tuscaloosa revenues. We continued throughout the second half of the fiscal year to experience mechanical and technical production problems with both the F-1 and F-3 wells. The F-1 and A-1 wells contributed approximately 26.35% of total revenues in the fiscal year ended February 29, 2008. It is anticipated that the F-3 well will return to production in the second quarter of calendar year 2008.

Costs and Expenses: Total operating expenses increased by 28.6% or \$76,056 for the fiscal year ended February 29, 2008 as compared to the prior fiscal year. This was caused by the installation of mechanical lifting equipment on the F-1 and F-3 wells.

A table of our costs and expenses for the fiscal year 2008 compared to the fiscal year 2007 follows:

	Fiscal Year 2008	Fiscal Year 2007
Production Costs	\$ 279,391	\$ 265,835
Exploration Costs	62,500	-
Total Operating Expenses	\$ 341,891	\$ 265,835

Oil and Gas Projects Update

Alabama (East Gilbertown Field)

Choctaw County. In December 2006, we acquired a working interest in an existing oil field project, the East Gilbertown Field (“Gilbertown”) that produces heavy oil (approximately 18° API). This field has nineteen wellbores most of which are capable of production.

From December 2006 through March 2007, we incrementally increased our working interest in this project from 2.5% to 12.5%. On June 1, 2007, we became the operator of the East Gilbertown Field. Future plans are to continue to increase production in the field by bringing more non-producing wellbores back into production. As of February 29, 2008, we had spent \$397,229 in leasehold, production and workover costs associated with this field. We plan to spend approximately \$100,000 in capital repairs and new investments within the field in the upcoming fiscal year.

California

East Slopes Project in Kern and Tulare Counties. In May 2005, we agreed to jointly explore an Area of Mutual Interest (“AMI”) in the southeastern part of the San Joaquin Basin. We initially paid a \$12,500 fee to secure the project and the geological concepts. Our agreement calls for us to also pay another \$5,000 fee upon the completion of each sub-regional lead that is developed for 3-D seismic survey. Additionally, we will pay another \$5,000 fee upon the spud of the first well in each prospect area.

Four prospect areas have been identified and we are actively leasing lands in the East Slopes project area. Additionally, we have identified two prospect areas to the north of the East Slopes AMI. This second AMI is referred to as the “Expanded AMI” project area. We have now jointly leased about 25,633 undeveloped acres in the two AMI’s. Drilling targets are porous and permeable sandstone reservoirs at depths of 1,200 feet to 4,000 feet. Daybreak has a 50% of the working interest in the area that is not in the Chevron partnered East Slopes AMI project area covered by the recently completed high definition 3-D seismic survey. As of February 29, 2008 we have spent \$778,806 in leasehold and geologic and geophysical costs associated with this project.

In June 2007, Daybreak and its partners (“Daybreak et al”), entered into a Seismic Option Farmout Agreement with Chevron U.S.A. Inc. (“Chevron”), for a seismic and drilling program in the East Slopes (Kern County) project area in California. By paying the full cost of the seismic program Chevron will earn a 50% interest in the Daybreak et al lands and a 50% (Daybreak 25%) working interest for the drilling of future wells in the project area. Daybreak et al will earn a 50% (Daybreak 25%) interest in the Chevron lands located in the same project area, by paying 100% of the cost of the first four initial test wells to be drilled on the jointly held lands. The four initial test wells must be drilled within nine months of the seismic data interpretation being completed. In January 2008 we announced that data processing is underway following the recently completed field acquisition of the 35 square-mile 3-D seismic survey. Drilling is expected to commence in the second fiscal quarter of 2008. We plan to spend approximately \$2,000,000 in new capital investments within the field in the upcoming fiscal year.

Louisiana

On January 18, 2008 we signed a purchase and sale agreement (“PSA”) for the sale of our Tuscaloosa project interests for \$8 million in cash. The transaction closed in three tranches; the first closing for \$2 million occurred on January 18, 2008; the second closing for \$500,000 occurred on April 30, 2008; and the final closing for \$5.5 million occurred on June 12, 2008 and was subject to customary closing adjustments. The sale includes Daybreak's interests in the Tensas Farms et al F-1, F-3, B-1, A-1 and F-2 wells; and all of its acreage and infrastructure in the project area. Under terms of the PSA, the effective dates for each closing was January 1, 2008.

Additionally, in January 2008, we finalized the acquisition of a 2% working interest in the Tuscaloosa project that had been jointly owned by three parties, two of whom we former officers and directors of the Company. The interest that we purchased represented a 1.5% working interest in the Tensas Farms et al B-1 well and a 0.5% working interest in the F-3 well. The NRI (net revenue interest) of these three parties was 0.38% in the F-3 well. The purchase included the rights to revenue from first production. We paid an aggregate \$27,808 for this interest. The sale was subject to the customary closing adjustments.

St. Landry Parish. The Krotz Springs Project is a deep gas play with current production coming from a Cockfield Sands reservoir. We were the operator for this project during the drilling and completion phases. When production commenced in May of 2007, the unitized field operator of the Krotz Springs Field became the operator for this well. Total project drilling and completion costs were approximately \$9.2 million. We have a 12.5% working interest in this project, with a net revenue interest (“NRI”) of 9.125%. As of February 29, 2008, we had spent \$1.16 million in leasehold, drilling, completion and production costs associated with this project. Current production is being evaluated prior to recompleting another prospective producing zone in the well in which Daybreak will spend approximately \$15,000 in the upcoming fiscal year.

In the North Shuteston prospect, the target is a three dimensional (“3-D”) seismic supported shallow amplitude anomaly at a depth of 2,300 feet. This anomaly is related to a Miocene Age Sand. On April 23, 2008, we conveyed our interest in this project to another party in exchange for a two percent (2.0%) overriding royalty interest (ORRI) in the production revenue from the start of production. Drilling will begin on this project during the summer of 2008, however Daybreak no longer has a working interest in this project, and therefore will not have a capital investment. As of February 29, 2008, we had spent about \$130,000 in leasehold, geologic and geophysical (“G&G”) and project management costs associated with this project.

Avoyelles Parish. This Prospect is a Cretaceous target positioned beneath an existing oilfield that has produced over 28 million barrels of oil. The project will initially focus on the broad northeast flank of the Cretaceous structure, targeting the Massive Sand of the Lower Tuscaloosa and the Fractured Lower (Austin) Chalk. Plans call for a 3-D seismic survey covering about 36 square miles. This is primarily a deep gas play. Gross project costs are estimated to be \$1,000,000 for land, \$3,000,000 for 3-D Seismic and \$6,000,000 for drilling the first well. We have jointly acquired leases or permits on approximately 2,002 gross undeveloped acres within the AMI. Daybreak has a 35% working interest in this project. As of February 29, 2008, we had spent \$431,484 in leasehold, seismic and project management costs associated with this project. We and our existing working interest partners are looking for other industry partners to participate in additional land acquisition and seismic costs before proceeding with drilling. We are not planning on spending any funds in capital new investments within the field in the upcoming fiscal year.

Texas

Nueces County. In November 2005, we agreed to jointly participate in a five well re-entry project in the Saxet Deep Field (“Saxet”) a previously produced oilfield, on a developed 320 acre lease. The project is located within the city limits of Corpus Christi, Texas, near the airport. We have a variable working interest in the project, with an average well working interest of 25.24% and an NRI of 14.25% on all production from these wells.

In May 2006, we started the re-work of the first well, the Weil 8-C well. This well was successfully reworked and placed into production in August 2006. In August and September 2006, we re-entered and started to produce from both the Weil 3-C and Weil 7-C wells. Two other wells the Weil 2-C and Weil 6-C were re-entered in September and October of 2006, and are now being used as salt water disposal wells.

As of February 29, 2008, we had spent \$702,569 in leasehold, workover, production, pipeline and production facility costs associated with this project.

We have continued to face increased production costs in the Saxet with a workover required on an existing salt water disposal well. The workover was completed in late September 2007. We anticipate being able to continue production of the field; however, there is no assurance that commercial returns will continue. We plan on spending approximately \$50,000 in capital new investments within the field in the upcoming fiscal year.

Other Liquidity Factors

At August 31, 2007, we had outstanding, two convertible debentures for an aggregate of \$200,001 that, along with accrued interest, were originally due on August 31, 2007. On August 31, 2007, the maturity on these convertible debentures was extended to October 31, 2007. On October 31, 2007, the \$75,000 convertible debenture plus accrued interest was paid off. The maturity of the other convertible debenture with a principal balance of \$125,001 was extended to January 31, 2008. On January 31, 2008, the \$125,001 debenture plus accrued interest was paid off.

In addition, at May 31, 2007, we had a note payable to a related party in the amount of \$200,000 for financing of the pipeline used on the F-1 and F-3 wells. In the 2nd quarter, principal payments of \$185,000 were made on this financing obligation. During the 3rd quarter of the current fiscal year, we paid in full the financed amount plus accrued interest that was due on this note payable.

In December 2007, we closed an unregistered offering through a private placement of our common stock under the securities transaction exemption Regulation D Rule 506 of the Securities Act of 1933. Shares were offered at \$0.25 per share to “accredited investors” only as defined in Regulation D under the Securities Act of 1933. The offering was closed on December 27, 2007. The shares were sold directly by Daybreak and no placement agent was involved in the offering. A total of 2,497,000 shares of unregistered common stock were sold to thirteen investors resulting in \$624,250 in gross proceeds. Offering expenses were approximately \$6,500. Net proceeds were used to meet our drilling commitments in the Tuscaloosa project and general and administrative expenses.

In January 2008, we commenced an unregistered offering through a private placement of our common stock under the securities transaction exemption Regulation D Rule 506 of the Securities Act of 1933. We propose to offer and sell 10,000,000 shares for gross proceeds of \$2,500,000. Shares will be offered and sold at \$0.25 per share to "accredited investors" only as defined in Regulation D under the Securities Act of 1933. An additional 1,000,000 common stock shares may be sold at our sole discretion. The shares will be sold directly by Daybreak or by commissioned placement agents. A 10% commission plus 3% non-accountable expense allowance will be paid to the placement agents. Additionally, the placement agents will earn warrants in the amount of 7% of their sales. The warrants will be exercisable for a period of three years at an exercise price of \$0.25. As of February 29, 2008, a total of 565,000 shares of unregistered common stock were sold to six investors resulting in \$141,250 in gross proceeds. Offering expenses were approximately \$23,112. Net proceeds of \$118,138 were used to meet our drilling commitments in the Tuscaloosa project and general and administrative expenses.

Management and Board of Directors Restructuring

On December 14, 2007, we underwent a change in the management of Daybreak. Robert N. Martin, President resigned from that position and was appointed Senior Vice-President, Exploration; Chief Executive Officer Eric L. Moe resigned from the Company; Timothy R. Lindsey formerly an outside director was appointed interim President and Chief Executive Officer; Chief Financial Officer Terrence J. Dunne resigned from the Company; and Controller Thomas C. Kilbourne resigned from that position but continued as an employee of Daybreak. James F. Westmoreland, formerly a finance and accounting consultant to Daybreak, was appointed interim Chief Financial Officer.

On December 18, 2007, the Board of Directors voted to reduce the number of Board positions to three. Subsequently, the following individuals resigned their positions and offices with the Board of Directors of Daybreak; Robert N. Martin, Eric L. Moe, Terrence J. Dunne, Jeffrey R. Dworkin, Thomas C. Kilbourne and Michael Curtis. Karol L. Adams, formerly a consultant to Daybreak, was appointed Corporate Secretary.

On March 24, 2008 James F. Meara was appointed to our Board of Directors, thereby expanding the Company's Board to four members.

On April 3, 2008, James F. Westmoreland, formerly interim Chief Financial Officer, was appointed Executive Vice President and Chief Financial Officer; Karol L. Adams was appointed Chief Compliance Officer in addition to the Corporate Secretary duties; Thomas C. Kilbourne was appointed Controller and Assistant Secretary; and Daybreak adopted a series of corporate responsibility statements and employee guidelines.

Off-Balance Sheet Arrangements

As of February 29, 2008, we did not have any relationships with unconsolidated entities or financial partners, such as entities often referred to as structured finance or special purpose entities, which have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Summary

Daybreak Oil and Gas has repositioned itself during its fiscal 2008 year agreeing to sell its Tuscaloosa Project property for \$8 million subject to customary closing adjustments. The first tranche of proceeds from this sale were used to pay off existing indebtedness, and the final two tranches will fund our upcoming drilling program at our East Slopes Project in California. We expect to begin drilling in the second quarter of 2008. The 3-D seismic acquisition phase over the entire are of mutual interest ("AMI") has been completed; the data has been processed and a portfolio of future drilling prospects is currently being identified. The wells at East Slopes will be relatively inexpensive to drill and complete compared to the Tuscaloosa project wells. A multi-well drilling program targeting moderately risked potential oil resources in California affords Daybreak exposure to attractive economic upside. Available capital resulting from the Tuscaloosa sale transaction also provides us with the financial flexibility to pursue other possible projects on a select basis as they become available.

ITEM 7. FINANCIAL INFORMATION

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of Daybreak Oil and Gas, Inc.
(An Exploration Stage Company)

We have audited the accompanying balance sheets of Daybreak Oil and Gas, Inc. (an exploration stage company) as of February 29, 2008 and February 28, 2007 and the related statements of operations, stockholders' equity, and cash flows for the years then ended and for the period from March 1, 2005 (inception) to February 29, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Daybreak Oil and Gas, Inc. as of February 29, 2008 and February 28, 2007 and the results of operations and cash flows for the periods described above, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 14 to the financial statements, the Company has restated its 2008 financial statements.

Malone & Bailey PC
www.malone-bailey.com
Houston, Texas

May 27, 2008 except for Note 7 and 13, which are as of July 11, 2008 and Notes 2 and 14 which are as of January 13, 2009.

Daybreak Oil and Gas, Inc.
(An Exploration Stage Company, Date of Inception March 1, 2005)
Balance Sheets
As of February 29, 2008 and February 28, 2007

	<u>As Restated 2008</u>	<u>2007</u>
ASSETS		
CURRENT ASSETS:		
Cash	\$ 59,133	\$ 377,957
Investment in marketable securities, at market, cost of \$155,445 and \$2,356,213 respectively	155,445	2,356,213
Accounts receivable:		
Oil and gas sales	311,277	56,906
Joint interest participants	502,420	799,970
Related party participants	-	41,357
Notes receivable (including accrued interest of \$28,336)	-	828,336
Prepaid expenses and other current assets	20,942	76,895
Total current assets	<u>1,049,217</u>	<u>4,537,634</u>
OIL AND GAS PROPERTIES, net of accumulated depletion, depreciation, amortization and impairment, successful efforts method	169,521	1,054,029
VEHICLES AND EQUIPMENT, net of accumulated depreciation of \$13,310 and \$4,355 respectively	18,019	18,556
Assets held for sale	1,634,471	3,498,821
Joint interest receivable – long term	500,000	-
OTHER ASSETS	<u>289,809</u>	<u>102,426</u>
Total assets	<u>\$ 3,661,037</u>	<u>\$ 9,211,466</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and other accrued liabilities	\$ 316,253	\$ 2,110,458
Note payable - related party	-	200,000
Convertible debentures, net of discount of \$ 90,002	-	134,999
Total current liabilities	<u>316,253</u>	<u>2,445,457</u>
OTHER LIABILITIES		
Asset retirement obligation	119,207	99,427
Total liabilities	<u>435,460</u>	<u>2,544,884</u>
COMMITMENTS		
STOCKHOLDERS' EQUITY:		
Preferred stock - 10,000,000 shares authorized, \$0.001 par value; Series A Convertible Preferred stock - 2,400,000 shares authorized, \$0.001 par value, 6% cumulative dividends; 1,297,465 and 1,399,764 shares issued and outstanding respectively	1,298	1,400
Common stock - 200,000,000 shares authorized; \$0.001 par value, 44,293,299 and 40,877,230 shares issued and outstanding respectively	44,294	40,877
Additional Paid-In Capital	21,980,785	20,224,411
Accumulated deficit	(736,035)	(736,035)
Deficit accumulated during the exploration stage	(18,064,765)	(12,864,071)
Total stockholders' equity	<u>3,225,577</u>	<u>6,666,582</u>
Total liabilities and stockholders' equity	<u>\$ 3,661,037</u>	<u>\$ 9,211,466</u>

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

DAYBREAK OIL AND GAS, INC.
(An Exploration Stage Company)

Statements of Operations

**For the Years ended February 29, 2008 and February 28, 2007 and for the Period
from Inception (March 1, 2005) to February 29, 2008**

	<u>Years Ended</u>		<u>From Inception Through</u>
	<u>(As Restated) February 29, 2008</u>	<u>February 28, 2007</u>	<u>(As Restated) February 29, 2008</u>
REVENUE:			
Oil and gas sales	\$ 366,850	\$ 154,788	\$ 521,638
OPERATING EXPENSES:			
Production costs	326,849	107,931	434,780
Exploration and drilling	654,765	1,196,640	2,241,374
Depreciation, depletion, amortization, and impairment	2,333,571	2,398,048	4,731,619
General and administrative	2,663,677	3,936,868	10,699,619
Total operating expenses	<u>5,978,862</u>	<u>7,639,487</u>	<u>18,107,392</u>
OPERATING LOSS	<u>(5,612,012)</u>	<u>(7,484,699)</u>	<u>(17,585,754)</u>
OTHER INCOME (EXPENSE):			
Administrative income	139,131	-	139,131
Interest income	43,550	101,697	145,607
Dividend income	3,691	5,547	9,238
Interest expense	(208,893)	(1,223,298)	(1,478,049)
Total other income (expense)	<u>(22,521)</u>	<u>(1,116,054)</u>	<u>(1,184,073)</u>
LOSS FROM CONTINUING OPERATIONS	<u>(5,634,533)</u>	<u>(8,600,753)</u>	<u>(18,769,827)</u>
Income from discontinued operations	<u>433,839</u>	<u>208,723</u>	<u>705,062</u>
NET LOSS	<u>(5,200,694)</u>	<u>(8,392,030)</u>	<u>(18,064,765)</u>
Cumulative convertible preferred stock dividend requirement	(395,923)	(155,316)	(551,239)
Deemed dividend - Beneficial conversion feature	<u>-</u>	<u>(4,199,295)</u>	<u>(4,199,295)</u>
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	<u>\$ (5,596,617)</u>	<u>\$ (12,746,641)</u>	<u>\$ (22,815,299)</u>
NET LOSS PER COMMON SHARE			
Loss from continuing operations	\$ (0.14)	\$ (0.23)	
Income from discontinued operations	0.01	0.01	
NET LOSS PER COMMON SHARE - Basic and diluted	<u>\$ (0.14)</u>	<u>\$ (0.34)</u>	
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - Basic and diluted			
	<u>41,292,659</u>	<u>37,045,509</u>	

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

DAYBREAK OIL AND GAS, INC.
(An Exploration Stage Company)
Statement of Changes in Stockholders' Equity
For the Period from Inception (March 1, 2005) through February 28, 2007

	Series A Convertible Preferred Stock		Common Stock		Additional Paid-In Capital (Restated)	Accumulated Deficit	Deficit Accumulated During the Exploration Stage (Restated)	Total (Restated)
	Shares	Amount	Shares	Amount				
<i>BALANCE, March 1, 2005 (Exploration stage date of inception)</i>	-	\$ -	18,199,419	\$ 18,199	\$ 709,997	\$ (736,035)	\$ -	\$ (7,839)
<i>Issuance of common stock for:</i>								
Cash	-	-	4,400,000	4,400	1,083,100	-	-	1,087,500
Services	-	-	5,352,667	5,353	3,622,176	-	-	3,627,529
Oil and gas properties	-	-	700,000	700	411,300	-	-	412,000
Conversion of convertible debentures and interest payable	-	-	806,135	806	200,728	-	-	201,534
<i>Discount on convertible notes payable</i>	-	-	-	-	1,240,213	-	-	1,240,213
Net loss	-	-	-	-	-	-	(4,472,041)	(4,472,041)
BALANCE, FEBRUARY 28, 2006	-	-	29,458,221	29,458	7,267,514	(736,035)	(4,472,041)	2,088,896
<i>Issuance of common stock for:</i>								
Cash	-	-	8,027,206	8,027	5,180,230	-	-	5,188,257
Services	-	-	1,270,000	1,270	2,606,430	-	-	2,607,700
Oil and gas properties	-	-	222,500	223	528,527	-	-	528,750
Conversion of convertible debentures	-	-	2,049,303	2,049	1,022,473	-	-	1,024,522
<i>Purchase and cancellation of common stock:</i>	-	-	(150,000)	(150)	(149,850)	-	-	(150,000)
<i>Issuance of preferred stock for:</i>								
Cash	1,399,765	1,400	-	-	3,624,804	-	-	3,626,204
Discount on convertible notes payable	-	-	-	-	25,000	-	-	25,000
Extension warrants on convertible notes payable	-	-	-	-	119,283	-	-	119,283
Discount on preferred stock	-	-	-	-	4,199,295	-	-	4,199,295
Deemed dividend on preferred stock	-	-	-	-	(4,199,295)	-	-	(4,199,295)
Net loss	-	-	-	-	-	-	(8,392,030)	(8,392,030)
BALANCE, FEBRUARY 28, 2007	1,399,765	\$ 1,400	40,877,230	\$ 40,877	\$ 20,224,411	\$ (736,035)	\$ (12,864,071)	\$ 6,666,582
<i>Issuance of common stock for:</i>								
Cash	-	-	3,062,000	3,062	728,754	-	-	731,816
Services	-	-	10,000	10	4,491	-	-	4,501
Conversion of convertible debentures	-	-	37,169	38	27,840	-	-	27,878
Extension warrants on convertible notes payable	-	-	-	-	60,973	-	-	60,973
Conversion of preferred stock	(102,300)	(102)	306,900	307	(205)	-	-	-
<i>Issuance of goodwill warrants</i>	-	-	-	-	934,521	-	-	934,521
Net loss	-	-	-	-	-	-	(5,200,694)	(5,200,694)
BALANCE, FEBRUARY 29, 2008, as restated	1,297,465	\$ 1,298	44,293,299	\$ 44,294	\$ 21,980,785	\$ (736,035)	\$ (18,064,765)	\$ 3,225,577

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

DAYBREAK OIL AND GAS, INC.
(An Exploration Stage Company)

Statements of Cash Flows

**For the Years ended February 29, 2008 and February 28, 2007 and for the Period
from Inception (March 1, 2005) through February 29, 2008**

	Years Ended		From Inception
	<u>February 29,</u> <u>2008</u>	<u>February 28,</u> <u>2007</u>	<u>March 1, 2005</u> <u>Through February</u> <u>29,</u> <u>2008</u>
	(As Restated)		(As Restated)
<i>CASH FLOWS FROM OPERATING ACTIVITIES</i>			
Net Loss	\$ (5,200,694)	\$ (8,392,030)	\$ (18,064,765)
Adjustments to reconcile net loss to net cash used in operating activities:			
Common stock issued for services	4,500	2,607,700	6,239,729
Depreciation, depletion, amortization and impairment expense	2,333,571	2,398,048	4,731,619
Exploration expense - dry wells	33,233	563,020	849,753
Non cash interest expense and accretion	164,873	1,209,529	1,470,051
Non cash interest and dividend income	(28,108)	(28,585)	(56,693)
Non cash general and administrative expense	934,521	-	934,521
Changes in assets and liabilities:			
Restricted cash	-	8,333	-
Investment in marketable securities	2,200,768	(2,356,213)	(155,445)
Accounts receivable - oil and gas sales	(254,371)	(56,906)	(311,277)
Accounts receivable - related party participants	41,357	(41,357)	-
Accounts receivable - joint interest participants	(702,450)	(799,970)	(1,502,420)
Prepaid expenses and other current assets	55,954	(76,645)	(20,500)
Deferred financing costs	-	10,000	-
Accounts payable and other accrued liabilities	(1,385,367)	1,604,626	802,542
Joint interest receivable – long term	500,000	-	500,000
Other assets	-	(77,177)	(77,177)
Net cash (used) in operating activities	<u>(1,302,213)</u>	<u>(3,427,627)</u>	<u>(4,660,062)</u>

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

CASH FLOWS FROM INVESTING ACTIVITIES:

Purchase of reclamation bond	(250,000)	(25,000)	(275,000)
Refund on equipment	-	250,000	-
Additions to note receivable	-	(800,000)	(800,000)
Purchases of oil and gas properties	(2,036,888)	(5,441,993)	(8,915,744)
Purchase of fixed assets	(8,930)	(22,911)	(31,841)
Proceeds from sale of oil and gas properties	2,000,000	-	2,000,000
Proceeds from note receivable	800,000	-	800,000
Additions to oil and gas prepayments	72,392	-	72,392
Net cash provided by (used) in investing activities	<u>576,574</u>	<u>(6,039,904)</u>	<u>(7,150,193)</u>

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from sales of preferred stock, net	-	3,626,204	3,626,204
Proceeds from sales of common stock, net	731,816	5,188,257	7,007,573
Proceeds from related party notes payable	-	200,000	200,000
Proceeds (repayments) from borrowings	(325,001)	25,000	1,035,520
Net cash provided by financing activities	<u>406,815</u>	<u>9,039,461</u>	<u>11,869,297</u>

NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS (318,824) (428,070) 59,042

CASH AND EQUIVALENTS AT BEGINNING OF PERIOD 377,957 806,027 91

CASH AT END OF PERIOD \$ 59,133 \$ 377,957 \$ 59,133

CASH PAID FOR:

Interest	\$ 41,327	\$ 13,769	\$ 55,096
Income taxes			

SUPPLEMENTAL CASH FLOW INFORMATION:

Common stock issued for services	\$ 4,500	\$ 2,607,700	\$ 6,239,729
Common stock issued for oil and gas properties	-	528,750	940,750
Common stock repurchased and cancelled	-	(150,000)	(150,000)
Common stock issued on conversion of convertible debentures and interest	27,878	1,024,522	1,253,934
Discount on convertible notes payable	60,973	25,000	1,326,186
Extension warrants on convertible notes payable	-	119,283	119,283
Conversion of preferred stock to common stock	\$ 185	\$ -	\$ 185

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

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

NOTE 1 — ORGANIZATION AND BASIS OF PRESENTATION:

Organization

Originally incorporated as Daybreak Uranium, Inc., (the “Company”), under the laws of the State of Washington on March 11, 1955, the Company was organized to explore for, acquire, and develop mineral properties in the Western United States. During 2005, management of the Company decided to enter the oil and gas exploration industry. On October 25, 2005, the shareholders approved a name change to Daybreak Oil and Gas, Inc. (“Daybreak”), to better reflect the business of the Company.

Basis of Presentation

The accompanying audited financial statements of Daybreak have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission.

Exploration Stage Company

On March 1, 2005 (the inception date), Daybreak commenced oil and gas exploration activities. As of February 29, 2008, Daybreak has not produced a sustainable positive cash flow from its oil and gas operations. Accordingly, Daybreak’s activities have been accounted for as those of an “Exploration Stage Enterprise” as set forth in SFAS No. 7, “Accounting for Development Stage Entities.” Among the disclosures required by SFAS No. 7 are that Daybreak’s financial statements be identified as those of an exploration stage company. In addition, the statements of operations, stockholders equity (deficit) and cash flows are required to disclose all activity since Daybreak’s date of inception.

Daybreak will continue to prepare its financial statements and related disclosures in accordance with SFAS No. 7 until such time that Daybreak’s oil and gas properties have generated significant revenues.

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 from those estimates.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Cash and Cash Equivalents

Cash equivalents include demand deposits with banks and all highly liquid investments with original maturities of three months or less.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

Restricted Cash

Daybreak classifies cash balances as “restricted cash” when cash is restricted as to withdrawal or usage. Daybreak did not have any cash balances designated as restricted at February 29, 2008.

Investment in Marketable Securities

Daybreak determines the appropriate classification of its investments in debt securities at the time of purchase and reevaluates such determinations at each balance-sheet date. Daybreak classifies all investments in marketable debt securities as trading securities as they are bought and held principally for the purpose of selling them in the near term. These securities are reported at fair value, with realized and unrealized gains and losses recognized in earnings. The fair value of all securities is determined by quoted market prices. These investments are not insured by the Federal Deposit Insurance Corporation.

Accounts and Notes Receivable

Daybreak routinely assesses the recoverability of all material trade and other receivables. Daybreak accrues a reserve on a receivable when, based on the judgment of management, it is probable that a receivable will not be collected and the amount of any reserve may be reasonably estimated. Actual write-offs may exceed the recorded allowance. No allowance for doubtful accounts was considered necessary at February 29, 2008 and February 28, 2007.

Oil and Gas Properties

Daybreak uses the successful efforts method of accounting for oil and gas property acquisition, exploration, development, and production activities. Costs to acquire mineral interests in oil and gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip development wells are capitalized as incurred. Costs to drill exploratory wells that are unsuccessful in finding proved reserves are expensed as incurred. In addition, the geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed as incurred. Costs to operate and maintain wells and field equipment are expensed as incurred.

Capitalized proved property acquisition costs are amortized by field using the unit-of-production method based on proved reserves. Capitalized exploration well costs and development costs (plus estimated future dismantlement, surface restoration, and property abandonment costs, net of equipment salvage values) are amortized in a similar fashion (by field) based on their proved developed reserves. Support equipment and other property and equipment are depreciated over their estimated useful lives.

Pursuant to SFAS No. 144, “Impairment or Disposal of Long-Lived Assets”, Daybreak reviews proved oil and natural gas properties and other long-lived assets for impairment. These reviews are predicated by events and circumstances, (such as downward revision of the reserve estimates or commodity prices), that indicate a decline in the recoverability of the carrying value of such properties. Daybreak estimates the future cash flows expected in connection with the properties and compares such future cash flows to the carrying amount of the properties to determine if the carrying amount is recoverable. When the carrying amounts of the properties exceed their estimated undiscounted future cash flows, the carrying amounts of the properties are reduced to their estimated fair value.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

The factors used to determine fair value include, but are not limited to, estimates of proved reserves, future commodity prices, the timing of future production, future capital expenditures and a risk-adjusted discount rate. Asset impairments of \$684,505 and \$1,606,292 were recorded for the years ended February 29, 2008 and February 28, 2007, respectively. The charge is included in depreciation, depletion and amortization.

As of February 29, 2008, Oil and Gas Properties net of accumulated depletion, depreciation, amortization and impairment were at \$169,521.

Unproved oil and gas properties that are individually significant are also periodically assessed for impairment of value. An impairment loss for unproved oil and gas properties is recognized at the time of impairment by providing an impairment allowance.

On the retirement or sale of a partial unit of proved property, the cost is charged to accumulated depreciation, depletion, and amortization with a resulting gain or loss recognized in income.

Deposits and advances for services expected to be provided for exploration and development or for the acquisition of oil and gas properties are classified as long term other assets.

As of February 29, 2008, \$12,617 had been advanced from Joint Interest Owners.

Property and Equipment

Fixed assets are stated at cost. Depreciation on vehicles is provided using the straight line method over expected useful lives of three years. Depreciation on machinery and equipment is provided using the straight line method over expected useful lives of three years.

Long Lived Assets

Daybreak reviews long-lived assets and identifiable intangibles whenever events or circumstances indicate that the carrying amounts of such assets may not be fully recoverable. Daybreak evaluates the recoverability of long-lived assets by measuring the carrying amounts of the assets against the estimated undiscounted cash flows associated with these assets. If this evaluation indicates that the future undiscounted cash flows of certain long-lived assets are not sufficient to recover the assets' carrying value, the assets are adjusted to their fair values (based upon discounted cash flows).

Debt

Daybreak recognizes interest expense for accrued interest payable under the terms of the debt. Principal and interest payments due within one year are classified as current, whereas principal and interest payments for periods beyond one year are classified as long term. Beneficial conversion features of debt are valued and the related amounts recorded as discounts on the debt. Discounts are amortized to interest expense using the effective interest method to the earliest date of conversion of the debt.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

Fair Value of Financial Instruments

The amounts of financial instruments including cash, deposits, deferred financing costs, prepaid expenses, accounts payable, convertible debentures, notes payable and interest payable approximated their fair values as of February 29, 2008 and February 28, 2007.

Share Based Payments

Prior to February 28, 2005, Daybreak accounted for its stock based compensation plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations, ("APB 25") as permitted by SFAS No. 123, "Accounting for Stock Based Compensation" ("SFAS 123").

Effective March 1, 2005, Daybreak adopted the fair value recognition provisions of SFAS No. 123, "Accounting for Stock Based Compensation" ("SFAS 123") for its stock based compensation plans under the recognition and measurement provisions of SFAS 123. No awards granted prior to March 1, 2005 were modified or settled in cash during fiscal 2006.

Effective March 1, 2006, Daybreak adopted the fair value recognition provisions of SFAS No. 123R, "Share Based Payment" and related Interpretations ("SFAS 123R").

Under both SFAS 123 and SFAS 123R, compensation cost for all share based payments granted on or subsequent to March 1, 2005 are based on the grant date fair value estimated in accordance with the provisions of SFAS 123 and SFAS 123R, for the respective fiscal years. Compensation cost is recognized on a straight line basis over the requisite service period for the entire award in accordance with the provisions of SFAS 123R. If at any date the portion of the grant date fair value of the award that is vested is greater than that amount recognized on a straight line basis, the amount of the vested grant-date fair value is recognized.

Daybreak accounts for transactions in which it issues equity instruments to acquire goods or services from non employees in accordance with the provisions of SFAS No. 123R (as amended). These transactions are accounted for based on the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable.

Loss per Share of Common Stock

Basic loss per share of common stock is calculated by dividing net loss available to common stockholders by the weighted average number of common shares issued and outstanding during the year. Common stock equivalents, including common stock issuable upon the conversion of loans and interest payable, are excluded from the calculations when their effect is anti-dilutive. At February 29, 2008 and February 28, 2007, the potential dilutive effect of converting notes payable and related interest to shares was determined to be anti-dilutive, and therefore their effect is excluded from the calculation of diluted weighted average shares.

Concentration of Credit Risk

Substantially all of Daybreak's accounts receivable result from natural gas and crude oil sales or joint interest billings to third parties in the oil and gas industry, operating in the United States. This concentration of customers and joint interest owners may impact Daybreak's overall credit risk as these entities could be affected by similar changes in economic conditions as well as other related factors.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

Accounts receivable are generally not collateralized. Historically, Daybreak has not experienced credit losses on its accounts receivable. At each of Daybreak's four producing projects, there is only one buyer for the purchase of oil or gas production. At the Tuscaloosa project in Louisiana, the F-1, F-3 and A-1 wells are supplying gas to a single customer pursuant to a gas supply agreement. As a result of the loss of customers by the gas purchaser, the F-1 and F-3 wells were, starting in July 2007 and continuing through November 2007, temporarily shut-in pending the securing of an alternative market for the natural gas produced by these two wells. The A-1 well did not start to produce until December 2007 when there were no production restrictions in place. In combination, the F-1 and F-3 wells contributed approximately 43% of total revenues during the fiscal year ended February 29, 2008. At February 29, 2008, five customers represented 100% of crude oil and natural gas sales receivable from all projects in aggregate.

In accordance with Statement of Financial Accounting Standards No. 131 ("SFAS 131"), a table disclosing the total amount of revenues from each major customer by product type follows:

Project	Location	Product	Customer	For the Year Ended February 29, 2008		For the Year Ended February 28, 2007	
				Revenue	Percentage	Revenue	Percentage
Tuscaloosa	Louisiana	Gas	Locust Ridge	\$ 267,022	33%	\$ 237,159	38%
		Oil	Plains Marketing	183,791	22%	237,434	38%
			Gulf Coast Gas				
Saxet	Texas	Gas	Gathering	155,222	19%	139,491	22%
Gilbertown	Alabama	Oil	Hunt Crude Oil				
			Supply	119,409	15%	N/A	N/A

In the Krotz Springs project in St. Landry Parish, Louisiana one of the working interest partners, California Oil & Gas, Inc. ("COGC") has defaulted on its twenty-five percent (25%) working interest obligation for the drilling and completion of the KSU #59 well. The balance of the default was \$587,464 as of February 29, 2008. As a partial payment of the outstanding balance, COGC has assigned their Net Revenue Interest ("NRI") of 18.25% in the production proceeds from the start of production to Daybreak. Additionally, Daybreak has filed a lawsuit in East Baton Rouge Parish, State of Louisiana seeking judgment in its favor in the amount of \$587,464 together with legal interest, attorney fees and all costs of the proceedings. Service of this lawsuit has been perfected on COGC and a hearing date in court has been set for the end of May, 2008. On May 1, 2008, Daybreak received from the unitized field operator \$108,428 that represented the production revenue net of severance tax that had been held in suspense under direction from Daybreak. This revenue was from the months of May 2007 through February 2008. These funds are being applied against the outstanding balance.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

Revenue Recognition

Daybreak uses the sales method to account for sales of crude oil and natural gas. Under this method, revenues are recognized based on actual volumes of oil and gas sold to purchasers. The volumes sold may differ from the volumes to which Daybreak is entitled based on its interests in the properties. These differences create imbalances which are recognized as a liability only when the imbalance exceeds the estimate of remaining reserves. Daybreak had no significant imbalances as of February 29, 2008 and February 28, 2007.

Reclamation Bonds

Included in other assets at February 29, 2008, is a \$25,000 certificate of deposit which has been pledged to the State of Louisiana. Also, included in other assets is a \$250,000 cash deposit as collateral for a \$250,000 surety bond with the State of Alabama. Both of these are in connection with asset retirement obligations for future plugging, abandonment and site remediation in Louisiana and Alabama. The pledging of these bonds was necessitated by Daybreak's emerging status as an oil and gas property operator in the States of Louisiana and Alabama.

Environmental Matters and Asset Retirement Obligation

Daybreak owns and has previously owned mineral property interests (which it has explored for commercial mineral deposits) on public and private lands in various states in the western United States. Daybreak and its properties are subject to a variety of federal and state regulations governing land use and environmental matters. Management believes it has been in substantial compliance with all such regulations. Management is also unaware of any pending action or proceeding relating to regulatory matters that would effect the financial position of Daybreak.

SFAS No. 143, "Accounting for Asset Retirement Obligations," addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement requires that Daybreak recognizes the fair value of a liability for an asset retirement obligation (ARO) in the period in which it is incurred. The ARO is capitalized as part of the carrying value of the assets to which it is associated, and depreciated over the useful life of the asset. An ARO and the related asset retirement cost are recorded when an asset is first drilled, constructed or purchased. The asset retirement cost is determined and discounted to present value using a credit-adjusted risk-free rate. After initial recording, the liability is increased for the passage of time, with the increase being reflected as accretion expense in the statements of operations. Subsequent adjustments in the cost estimate are reflected in the ARO liability and the amounts continue to be amortized over the useful life of the related long-lived asset.

Suspended Well Costs

On April 4, 2005, the Financial Accounting Standards Board, (FASB) issued FASB Staff Position No. 19-1, "Accounting for Suspended Well Costs" (FSP No. 19-1). This staff position amends SFAS No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies" and provides guidance concerning exploratory well costs for companies that use the successful efforts method of accounting. Daybreak adopted FSP No. 19-1 for the fiscal years ended February 29, 2008 and February 28, 2007.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

The position states that exploratory well costs should continue to be capitalized if: (1) a sufficient quantity of reserves are discovered in the well to justify its completion as a producing well and (2) sufficient progress is made in assessing the reserves and the economic and operating feasibility of the well. If the exploratory well costs do not meet both of these criteria, these costs should be expensed, net of any salvage value. Additional annual disclosures are required to provide information about management's evaluation of capitalized exploratory well costs.

In addition, the FSP requires annual disclosure of: (1) net changes from period to period of capitalized exploratory well costs for wells that are pending the determination of proved reserves, (2) the amount of exploratory well costs that have been capitalized for a period greater than one year after the completion of drilling and (3) an aging of exploratory well costs suspended for greater than one year, designating the number of wells the aging is related to. Further, the disclosures should describe the activities undertaken to evaluate the reserves and the projects, the information still required to classify the associated reserves as proved and the estimated timing for completing the evaluation.

Provisions for Taxes

Daybreak has adopted SFAS No. 109 "Accounting for Income Taxes". Pursuant to this pronouncement, income taxes are accounted for using an asset and liability approach. SFAS No. 109 requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statements and tax bases of assets and liabilities at the applicable tax rates. A valuation allowance is utilized when it is more likely than not, that some portion of, or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Recent Accounting Pronouncements

Daybreak does not expect the adoption of any recently issued accounting pronouncements to have a significant effect on its material position or results of operation.

Reclassifications

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

NOTE 3 – INVESTMENTS IN MARKETABLE SECURITIES:

Daybreak periodically invests excess cash on hand in marketable securities with the intent to sell the securities in the near term as cash requirements determine. At February 29, 2008, Daybreak held \$155,445 in a brokerage account which was invested in mutual funds that invested in fixed income securities with relatively low market risk. These securities are classified as trading securities under the provisions of SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities". During the year ended February 29, 2008, Daybreak earned \$47,241 in interest and dividend income from these investments. The market value of the securities as at February 29, 2008 was equal to their book value and no trading gains or losses occurred during the year.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

NOTE 4 – ACCOUNTS RECEIVABLE – JOINT INTEREST PARTICIPANTS:

In June 2007, Daybreak as Operator for the drilling and completion phases of the KSU #59 (formerly Haas-Hirsch No. 1) well, located in the Krotz Springs Field in St. Landry Parish, Louisiana, sent a notice of default to California Oil & Gas, Inc., (“COGC”) a 25% working interest participant for their delinquency in meeting the financial commitments in the drilling and completion of the KSU #59 well. Additionally, the Unitized Field Operator, was notified to place all revenue payments to COGC in suspense until the delinquency had been cured. Between August and October 2007, the Company received an aggregate of \$199,970 in payments on this delinquency. In January 2008, Daybreak instituted legal action against COGC for their default. As of February 29, 2008 the outstanding balance on this account was \$608,489. On May 1, 2008, Daybreak as part of a revenue assignment agreement with COGC received a payment of \$108,427, representing the net revenue proceeds that had been held in suspense by the Unit Operator since production began in May 2007. Daybreak intends to vigorously pursue all legal remedies available to settle this outstanding debt.

NOTE 5 - NOTES RECEIVABLE - DRILLING RIG AGREEMENT:

Daybreak advanced a total of \$800,000 to Green River Drilling, LLC through November 30, 2006, under promissory note agreements for the refurbishment of a drilling rig. In May 2007, Daybreak was informed by Green River that they intended to sell the drilling rig to a third party. The sale was completed and in June 2007, Daybreak received a total of \$846,668 which represented the proceeds and interest from the \$800,000 note receivable.

NOTE 6 — OIL AND GAS PROPERTIES:

Oil and gas properties, at cost:

	<u>Year Ended</u> <u>February 29, 2008</u>	<u>Year Ended</u> <u>February 28, 2007</u>
Proved leasehold costs	\$ 299,571	\$ 125,000
Unproved leasehold costs	104,700	165,261
Costs of wells and development	1,732,958	574,933
Unevaluated capitalized exploratory well costs	-	599,442
Capitalized asset retirement costs	22,740	25,711
Total cost of oil and gas properties	2,159,969	1,490,347
Accumulated depletion, depreciation, amortization and impairment	(1,990,448)	(436,318)
Oil and gas properties, net	<u>\$ 169,521</u>	<u>\$ 1,054,029</u>

Suspended Well Costs

As of March 1, 2005, the Company adopted FASB Staff Position FAS 19-1, "Accounting for Suspended Well Costs." Upon adoption of the FSP, the Company evaluated all existing capitalized exploratory well costs under the provisions of the FSP.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

The Company had no capitalized exploratory wells costs at the time of adoption of FAS 19-1 or as of February 28, 2006. The following table reflects the net changes in capitalized exploratory well costs during the fiscal year ended February 29, 2008, and does not include amounts that were capitalized and subsequently expensed in the same period.

	<u>2008</u>	<u>2007</u>
Beginning balance at March 1 of fiscal year	\$ 599,442	\$ -
Total Exploration Well Additions	33,233	2,385,120
Reclassifications to wells, facilities, and equipment based on the determination of proved reserves	(599,442)	(1,222,658)
Capitalized exploratory well costs charged to expense		(563,020)
Ending Balance at February 29 of fiscal year	<u>\$ 33,233</u>	<u>\$ 599,442</u>

The following table provides an aging of capitalized exploratory well costs based on the date the drilling was completed and the number of projects for which exploratory well costs have been capitalized for a period greater than one year since the completion of drilling:

Fiscal year	<u>2008</u>
Capitalized exploratory well costs that have been capitalized for a period of one year or less	\$ 33,233
Balance at February 29 of fiscal year	<u>\$ 33,233</u>

Impairment of oil and gas properties

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets", if impairment is necessary, the asset carrying value is written down to fair value. Cash flow pricing estimates are based on existing proved reserve and production information and pricing assumptions that management believes are reasonable. Unproved oil and gas properties that are individually significant are periodically assessed for impairment by providing an impairment allowance. As of February 29, 2008, Daybreak expensed \$684,505 as impairment on proved properties.

Asset Retirement Obligation

Daybreak's financial statements reflect the provisions of Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations". Our asset retirement obligation ("ARO") primarily represents the estimated present value of the amount Daybreak will incur to plug, abandon and remediate its producing properties at the end of their productive lives, in accordance with applicable state laws. Daybreak determines the ARO on its oil and gas properties by calculating the present value of estimated cash flows related to the liability. At February 29, 2008, the liability for ARO was \$119,207, all of which is considered long term. The asset retirement obligations are recorded as current or non-current liabilities based on the estimated timing of the anticipated cash flows. For the year ended February 29, 2008 and February 28, 2007, Daybreak has recognized accretion expense of \$9,943 and \$5,970, respectively.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

The following table describes the changes in the asset retirement obligations for the year ended February 29, 2008.

Asset retirement obligations, beginning of period	\$ 99,427
Accretion expense	9,943
Asset retirement addition	9,837
Asset retirement obligations, end of period	<u>\$ 119,207</u>

NOTE 7 — DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE:

On January 18, 2008 Daybreak signed a purchase and sale agreement (“PSA”) for the sale of its Tuscaloosa project interests for \$8 million in cash. The transaction closed in three tranches; the first closing for \$2 million closed on January 18, 2008; the second closing for \$500,000 occurred on April 30, 2008; and the final closing for \$5.5 million occurred on June 12, 2008 and was subject to customary closing adjustments. The sale includes Daybreak's interests in the Tensas Farms et al F-1, F-3, B-1, A-1 and F-2 wells; and all of its acreage and infrastructure in the project area. Under terms of the PSA, the effective dates for each closing was January 1, 2008.

	<u>2008</u>	<u>2007</u>
Oil and gas sales revenues – Tuscaloosa project	\$ 650,754	\$ 474,558
Cost and Expenses	(216,915)	(265,835)
Income from discontinued operations	<u>\$ 433,839</u>	<u>\$ 208,723</u>

Oil and gas properties, at cost for discontinued operations:

	<u>Year Ended February 29, 2008</u>	<u>Year Ended February 28, 2007</u>
Proved leasehold costs	\$ 1,556,423	\$ 1,967,107
Unproved leasehold costs	310,657	737,156
Costs of wells and development	1,393,790	1,461,010
Unevaluated capitalized exploratory well costs	896,067	1,223,177
Capitalized asset retirement costs	<u>57,567</u>	<u>67,746</u>
Total cost of oil and gas properties	4,214,504	5,456,196
Accumulated depletion, depreciation, amortization and impairment	(2,580,033)	(1,957,375)
Oil and gas properties, net	<u>\$ 1,634,471</u>	<u>\$ 3,498,821</u>

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

The following table reflects the net changes in capitalized exploratory well costs for discontinued operations during the fiscal year ended February 29, 2008, and does not include amounts that were capitalized and subsequently expensed in the same period.

	<u>2008</u>	<u>2007</u>
Beginning balance at March 1 of fiscal year	\$ 1,223,177	\$ -
Total Exploration Well Additions	517,316	1,223,177
Sales of exploratory wells	(844,426)	-
Ending Balance at February 29 of fiscal year	<u>\$ 896,067</u>	<u>\$ 1,223,177</u>

NOTE 8 — CONVERTIBLE DEBENTURES:

During the fiscal years ended February 28, 2006 and February 28, 2007, there were three issuances of Convertible Debentures to various accredited individual investors by Daybreak. The convertible debentures had a one year maturity date and were convertible into shares of Daybreak's unregistered common stock at conversion prices of \$0.25, \$0.50 and \$0.75, respectively. In December of 2005, Daybreak issued a convertible promissory note ("Convertible Promissory Note") to an accredited investor pursuant to a warehousing line of credit arrangement with a related party. The Convertible Promissory Note was convertible into unregistered common stock at a conversion price of \$0.25.

The following table summarizes the issuances of Convertible Debentures and the Convertible Promissory Note:

Description	Interest Rate	Dates of Maturity	<u>2008</u>	<u>2007</u>
<i>Principal balance, beginning of year</i>			\$ 134,999	\$ 1,138,701
<i>Principal issuances</i>				
\$0.25 Convertible Debentures	6%	03/22/06 to 08/31/06	-	-
\$0.50 Convertible Debentures	10%	01/26/07 to 02/26/07	-	-
\$0.75 Convertible Debentures	10%	02/26/07 to 10/31/07	-	25,000
\$0.25 Convertible Promissory Note	0%	06/30/06	-	-
<i>Total issuances during the year ended</i>			-	1,163,701
<i>Principal converted during the year</i>				
\$0.25 Convertible Debentures	6%		-	(32,000)
\$0.50 Convertible Debentures	10%		-	(806,700)
\$0.75 Convertible Debentures	10%		-	(100,000)
\$0.25 Convertible Promissory Note	0%		-	-
<i>Total conversions during the year ended</i>			-	-
<i>Principal paid in cash</i>			(134,999)	-
<i>Principal balance, end of year</i>			-	225,001
<i>Unamortized discount, end of year</i>			-	(90,002)
Total debt, net of discount			<u>\$ 0</u>	<u>\$ 134,999</u>

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Twenty-Six (26) of the 6% interest \$0.25 convertible debentures for a total of \$158,821 were with related parties that included officers, directors and greater than 10% shareholders.

One of the 10% interest \$0.50 convertible debentures for a total of \$200,000 was with Hooper Group, LLC, an entity controlled Keith Hooper a Daybreak shareholder (greater than 5%).

Under the warehousing line of credit Convertible Promissory Note, Daybreak was advanced \$60,000 and had the option to request an additional \$120,000 upon completion of the Ginny South prospect in Texas. The Convertible Promissory Note was guaranteed by a director of the company. The Convertible Promissory Note had no stated interest and contained the option to convert the note into Daybreak common stock. All advances under the Convertible Promissory Note could also be converted into common stock of the Company at or prior to the maturity date.

No discount was recorded for the imputed interest rate on the Convertible Promissory Note as a beneficial conversion feature of \$60,000 was recognized upon issuance in accordance with EITF 00-27 and 98-5. The beneficial conversion feature was recognized as a discount on the Convertible Promissory Note and amortized utilizing the effective interest method, over the period commencing on the issuance date to the date of stated redemption of the debt in accordance with EITF 00-27.

In February 2006, the \$60,000 advance on the line of credit, as secured by the Convertible Promissory Note, was converted into Daybreak common stock. Upon conversion, the remaining discount was recognized as interest and the Convertible Promissory Note was cancelled. Financing costs for the Convertible Promissory Note were paid by issuing 66,000 shares of unregistered common stock to the issuer and another related party. The common stock fair value of \$38,380 was recognized as interest expense on the date of grant and the fair value was determined using Daybreak's trading price on the date of grant.

The holders of the \$0.25 Convertible Debentures had the option to convert their debentures (including accrued interest of 6%) into Daybreak's common stock at any time after six months had elapsed from the date of issuance. In accordance with EITF 00-27 and 98-5, beneficial conversion features of \$73,511 were recognized upon issuance of the debentures. The beneficial conversion features were recognized as discounts on the debentures at the date of issuance and amortized using the effective interest method to the earliest of the maturity date or the date conversion. As of February 28, 2007, the entire issuance of the \$0.25 convertible debentures had been converted into unregistered common stock and the \$73,511 discount had been recognized.

The holders of the \$0.50 Convertible Debentures had the option to convert their debentures (including accrued interest of 10%) into Daybreak's common stock at any time after sixty-one (61) days had elapsed from the date of issuance. In accordance with EITF 00-27 and 98-5, beneficial conversion features of \$806,700 were recognized upon issuance of the debentures. The beneficial conversion features were recognized as discounts on the debentures at the date of issuance and amortized using the effective interest method to the earliest of the maturity date or the date of conversion. As of February 28, 2007, the entire issuance of the \$0.50 convertible debentures had been converted into unregistered common stock and the \$806,700 discount had been recognized.

The holders of the \$0.75 Convertible Debentures had the option to convert their debentures (including accrued interest of 10%) into Daybreak's common stock at any time after sixty-one (61) days had elapsed from the date of issuance. In accordance with EITF 00-27 and 98-5, beneficial conversion features of \$325,001 were recognized upon issuance of the debentures.

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The beneficial conversion features were recognized as discounts on the debentures at the date of issuance and amortized using the effective interest method to the earliest of the maturity date or the date conversion. As of February 28, 2007, \$100,000 of the \$0.75 convertible debentures, including accrued interest of 10%, had been converted into unregistered common stock and the \$325,001 discount had been recognized. As of February 29, 2008, the balance of the convertible debentures had been redeemed for their principal amounts plus accrued interest.

In December 2006, the three holders of the \$0.75 convertible debentures, agreed to extend the due date of the debentures to August 31, 2007. In consideration of the term extension the debenture holders were issued a total of 150,001 warrants. The warrants were valued at \$119,283 using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.7%; the current stock price at date of issuance of \$1.04 per share; the exercise price of the warrants of \$2.00; the term of five years; volatility of 117%; and dividend yield of 0.0%. The value of the warrants was recognized at the time of issuance as a discount against the existing convertible debentures and is being amortized using the effective interest method until maturity.

On April 30, 2007, one of the convertible debenture holders converted to Daybreak unregistered common stock. A total of 37,169 shares were issued to satisfy the debt. On August 31, 2007, the remaining two debenture holders agreed to extend the term of the debentures to October 31, 2007. In consideration of this extension they received 112,000 warrants. The warrants were valued at \$35,386 using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.1 %; the current stock price at date of issuance of \$0.53 per share; the exercise price of the warrants of \$0.53; the term of two years; volatility of 114%; and dividend yield of 0.0%. The value of the warrants was recognized at the time of issuance as a discount against the existing convertible debentures and is being amortized using the effective interest method until maturity.

On October 31, 2007, one of the two remaining convertible debenture holders received proceeds of \$76,756.87, representing the principal plus accumulated interest of the convertible debenture. The other convertible debenture holder agreed to extend the term of his debenture until January 31, 2008. In consideration of the term extension he received 90,000 warrants. The warrants were valued at \$25,587 using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 3.9 %; the current stock price at date of issuance of \$0.40 per share; the exercise price of the warrants of \$0.25; the term of two years; volatility of 121.64%; and dividend yield of 0.0%. The value of the warrants was recognized at the time of issuance as a discount against the existing convertible debentures and was amortized using the effective interest method until maturity.

On January 31, 2008, the remaining convertible debenture holder received proceeds of \$128,151.71 representing the principal plus accumulated interest of the convertible debenture.

Daybreak has evaluated the application of SFAS No. 133 and EITF 00-19 for the consideration of embedded derivatives with respect to the conversion features for each of the Convertible Debentures and the Convertible Promissory Note. Daybreak has concluded that the instruments did not contain embedded derivatives.

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NOTE 9 — RELATED PARTY TRANSACTIONS:

Office Lease

Daybreak leases offices from Terrence J. Dunne & Associates, a company owned by Terrence J. Dunne (former Chief Financial Officer, director and current 8.8% shareholder). In May 2007, Daybreak increased their office size from 850 to approximately 1,000 square feet and monthly lease payments increased from \$1,000 to \$1,250 per month. This office lease is currently on a month-to-month basis. On January 1, 2008, the monthly rent was reduced to \$1,000 per month because of a reduction in the square footage being leased.

Financing of Gas Pipeline

On May 24, 2006, Daybreak financed its forty percent (40%) working interest in the Tuscaloosa project gas pipeline through a financing arrangement with Hooper Oil & Gas Partners, LLC (“Hooper O&G”). This pipeline services the Tensas Farms et al F-1 well in Tensas Parish, Louisiana. Hooper O&G is a company controlled by Keith A. Hooper (a greater than 5% shareholder).

Daybreak has accounted for this agreement as a financing arrangement in the form of a note payable with a principal balance of \$200,000. Daybreak was obligated to pay \$5,000 per quarter in interest until the principal was paid in full. Daybreak was also required to pay an additional 1% interest fee based on Daybreak’s original net revenue interest (“NRI”) on the gas production revenue of the F-1 well for the life of the well. Daybreak was obligated to repay the note between the sixth and the thirtieth (30th) month after the operation of the pipeline had commenced. Under the agreement, title transferred to Hooper O&G, however Hooper O&G was obligated to sell the interest and title back to Daybreak and couldn’t sell the interest to any other party.

Daybreak was required to commence repayment of the loan if production from the F-1 well should cease for any cause for a period exceeding sixty days. Daybreak made payments of \$100,000 on June 14, 2007 and \$58,245 on August 28, 2007. Due to the shut-in status of the F-1 well the accelerated repayment schedule was triggered. The loan was repaid in full on November 29, 2007.

Common Stock and Cash for Services

Under SFAS No. 123R the guidelines for recording stock issued for goods or services require the fair value of the shares granted be based on the fair value of the goods or services received or the publicly traded share price of Daybreak’s registered shares on the date the shares were granted (irrespective of the fact that the shares granted were unregistered), whichever is more readily determinable. This position has been further clarified by the issuance of SFAS No. 157. Accordingly, Daybreak elected an early application of these guidelines. Daybreak has determined that the fair value of all common stock issued for goods or services is more readily determinable based on the publicly traded share price on the date of grant.

From March 1, 2005 through February 29, 2008, Daybreak had contracts with 413294 Alberta, Ltd. to provide the services of Robert N. Martin as President (resigned as President and director December 14, 2007, and appointed Senior Vice-President, Exploration). For the fiscal year ended February 28, 2007, 413294 Alberta, Ltd. was paid a total of \$161,500 and 250,000 shares of unregistered common stock valued at \$597,500.

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The shares of common stock were expensed at the grant date. For the fiscal year ended February 29, 2008, 413294 Alberta Ltd. was paid a total of \$186,000 for services rendered.

From March 1, 2005 through February 29, 2008, Daybreak had contracts with Jeffrey R. Dworkin (resigned as Secretary and director December 14, 2007) for services in regards to public company corporate governance and oil and gas mineral rights and leases. For the fiscal ended February 28, 2007, Mr. Dworkin was paid a total of \$36,191. For the fiscal year ended February 29, 2008, Mr. Dworkin was paid \$31,550 for services rendered.

For the fiscal year ended February 28, 2007, Mr. Anderson was employed as Chief Operating Officer and paid \$98,500 in cash for services. For the Fiscal year ended February 29, 2008, Mr. Anderson was compensated \$126,000 in cash for services rendered.

From January 2, 2007 through February 29, 2008, Daybreak had a contract with Timothy R. Lindsey (director; appointed Interim Chief Executive Officer and President December 14, 2007) to facilitate long range strategic planning and advise Daybreak in business and exploration matters in the oil and gas industry. Under the terms of his contract, Mr. Lindsey was granted 200,000 shares of unregistered common stock valued at \$260,000. The contract provides compensation for services on a daily rate and no payments were made under the contract as of February 28, 2007. For the fiscal year ended February 29, 2008, Mr. Lindsey was paid \$21,000 for services rendered.

During the fiscal year ended February 28, 2007, Eric L. Moe (resigned as Chief Executive Officer and director December 14, 2007) was compensated \$103,500 in cash and granted 500,000 shares of unregistered common stock valued at \$1,100,000. For the fiscal year ended February 29, 2008, Mr. Moe received compensation of \$105,000 for services rendered.

During the fiscal year ended February 28, 2007, Thomas C. Kilbourne (resigned as Treasurer and director December 14, 2007) was compensated \$84,500 in cash and granted 100,000 shares of unregistered common stock valued at \$239,000. For the fiscal year ended February 29, 2008, Mr. Kilbourne received compensation of \$102,000 for services rendered.

During the fiscal year ending February 28, 2007, Daybreak paid nine directors a total of \$69,750 cash for directors' fees. For the fiscal year ended February 29, 2008, fees paid to the nine directors total \$81,000.

Convertible Debentures

Of the \$168,821 Convertible Debentures \$0.25 series issued in the fiscal year ended February 28, 2006, \$158,821 were issued to five individuals who were considered to be related parties at the time. In the fiscal year ended February 28, 2006, twenty-three of the related party convertible debentures representing \$126,821 in principal were converted, resulting in 524,820 shares of unregistered common stock being issued to satisfy the principal and interest obligations. By February 28, 2007, all twenty-six of related party convertible debentures were converted resulting in a total of 662,360 shares of unregistered common stock being issued to satisfy principal and interest obligations.

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Of the \$806,700 in convertible debenture of the 10% interest \$0.75 series, \$200,000 was from Hooper Group, LLC, an entity controlled by Keith Hooper a Daybreak shareholder (greater than 5%). In the fiscal year ended February 28, 2007, these notes were converted for 440,000 shares of unregistered common stock to satisfy the principal and interest obligations.

Purchase of Additional Working Interest in Tuscaloosa Project

During the fourth quarter of the fiscal year ended February 28, 2008, the Company finalized the acquisition of an additional 2% working interest in the Tuscaloosa project in Louisiana that had been jointly owned by three parties, two of whom were 413294 Alberta Ltd. and Tempest Energy, Inc. Robert N. Martin (former President and director; currently Senior Vice-President, Exploration) and Eric L. Moe (former Chief Executive Officer and director) are each the President of their respective companies. The interest purchased represented a 1.5% working interest in the Tensas Farms et al B-1 well and a 0.5% working interest in the F-3 well. The NRI (net revenue interest) of these three parties was 0.38% in the F-3 well. The purchase included the rights to revenue from first production. Daybreak paid an aggregate \$27,808 for this interest. The sale was subject to the customary closing adjustments.

NOTE 10 — STOCKHOLDERS' EQUITY:

Series A Convertible Preferred Stock

Daybreak is authorized to issue up to 10,000,000 shares of \$0.001 par value preferred stock. Daybreak has designated 2,400,000 shares of the 10,000,000 total preferred shares as "Series A Convertible Preferred Stock" ("Series A Preferred"), with a \$0.001 par value. During the year ended February 28, 2007, Daybreak conducted a private placement sale of Series A Preferred (the "July 2006 Preferred Stock Private Placement"). Each sale unit consisted of one share of Series A Preferred and two common stock purchase warrants. The units were sold for \$3.00 per unit, with a total of 1,399,765 units sold; resulting in gross proceeds of \$4,199,295. Daybreak received net proceeds of \$3,626,204 after placement agent fees, commissions and other offering costs of \$573,091.

The Series A Preferred can be converted by the shareholder at any time into three shares of Daybreak's common stock. If Daybreak's common stock is registered under the Securities Act of 1933, the Series A Preferred shall be automatically converted into common stock at any time after the effective date of the registration statement if Daybreak's common stock closes at or above \$3.00 per share for twenty (20) out of thirty trading days (30) days. Holders of Series A Convertible Preferred stock earn a dividend, in the amount of 6% of the original purchase price per year. Accumulated dividends do not bear interest. Dividends can be paid in cash or stock, are payable upon declaration by the Board of Directors and none have been declared.

The Warrants included in the private placement, are exercisable for a period of five years after the closing date at an exercise price of \$2.00 per share. In accordance with EITF 98-5, Daybreak valued the warrants and the beneficial conversion feature of the preferred stock. Accordingly, Daybreak recorded a discount for the warrants and beneficial conversion feature (BCF), of \$4,199,295. The discount is attributable to the fair value of the Warrants and the intrinsic value of the conversion feature of the preferred stock. The value of the BCF was recognized and measured separately by allocating to additional paid-in capital the proceeds equal to the \$1,489,222 relative fair value of the Warrants and the \$2,710,073 intrinsic value of the conversion feature.

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Daybreak also recorded a deemed dividend to reflect the full amortization of the discount of the value of the Warrants and conversion features of \$4,199,295. The fair value of each Warrant granted was estimated using the Black-Scholes pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.99%; the current stock price at date of issuance of \$2.20 per share; the exercise price of the warrants at \$1.00; an expected term of five years; volatility of 113%; and dividend yield of 0.0%. As of February 29, 2008, no subscriber warrants had been exercised.

Bathgate Capital Partners, of Denver, Colorado (Bathgate) was the placement agent. Joseph Lavigne, son of Dale B. Lavigne (the Chairman and a director of Daybreak) is an employee of Bathgate. Bathgate was paid a sales commission of 10% of the gross proceeds of the private placement and a non-accountable expense allowance of 3% of the gross proceeds totaling \$547,589. For every \$30.00 invested, Bathgate earned three common stock purchase warrants exercisable at \$1.00 per share. The warrants are exercisable for a period of five years. A total of 419,930 warrants were issued to Bathgate from this private placement and were valued at \$816,374. The placement agent warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.99%; the current stock price at date of issuance of \$2.20 per share; the exercise price of the warrants at \$1.00; an expected term of five years; volatility of 113%; and dividend yield of 0.0%. As of February 29, 2008, no placement agent warrants had been exercised.

Both the subscriber warrants and the placement agent warrants contain customary anti-dilution provisions. The anti-dilution provisions permit the adjustment of the number of shares issuable upon exercise of the warrants in the event of stock splits, stock dividends, stock reversals and sales of substantially all of the Company's assets. The placement agent warrants also contain a cashless exercise provision. The cashless exercise provision allows for the holder of the warrants to receive a number shares equal to the quotient of a) the product of the number of warrants held and the amount by which Daybreaks market traded stock price exceeds the exercise price of the warrants on the date of exercise, divided by b) the market traded stock price.

Daybreak agreed to register the Series A Preferred shares on a "best efforts" basis. If Daybreak was unable to file the registration statement within the filing timeline, Daybreak would have to issue 1,399,765 additional warrants at an exercise price of \$2.00 per share. Daybreak was required to file the registration statement within sixty (60) days after the registration statement for the common stock private placement from the May of 2006 became effective. Daybreak did file the registration statement on time and no additional warrant issuances were required.

In February 2008, Daybreak issued "goodwill" common stock warrants to the participants of the July 2006 private placement. The warrants were issued as a goodwill gesture to investors in the two 2006 private placements due to the inability to complete the respective registration statement; recognizing, this was a result of regulatory process delays rather than any fault of the Company. Each participant was offered one "goodwill" warrant for every unit that had been purchased in exchange waiving their rights under the Registration Rights Agreement. On November 6, 2007, the date our Board approved issuing these "goodwill" warrants, the closing price of our stock was \$0.40. As of February 29, 2008, we had received Registration Rights waiver letters from approximately 77% of the participants in this private placement. The warrants will expire on February 14, 2010, have an exercise price of \$0.65 and contain a cashless exercise provision. We have issued 1,121,267 goodwill warrants valued at \$254,283 to these investors. A total of 1,399,765 warrants could be issued.

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The warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 3.7 %; a term of two years; volatility of 121.67%; and dividend yield of 0.0%.

Daybreak evaluated the application of SFAS No. 133 and EITF 00-19 with respect to the conversion feature and the registration rights for consideration of embedded derivatives and concluded that the preferred stock and registration rights instruments did not have embedded derivatives.

The relative fair values of the Series A Convertible Preferred Shares and the Common Stock Purchase Warrants were as follows:

Description	Shares	Relative Fair Value Amount
Series A Convertible Preferred	1,399,765	\$ 2,710,073
Common Stock Purchase Warrants	2,799,530	1,489,222
Total Proceeds		4,199,295
Offering Costs		(573,091)
Net Proceeds		<u>\$ 3,626,204</u>

Common Stock

Daybreak is authorized to issue up to 200,000,000 shares of \$0.001 par value common stock. Commencing on January 2, 2008, Daybreak began conducting an unregistered offering of common stock through a private placement under the securities transaction exemption Regulation D Rule 506 of the Securities Act of 1933. Shares are offered at \$0.25 per share to “accredited investors” only as defined in Regulation D under the Securities Act of 1933. The shares are being sold directly by Daybreak and also by an unnamed placement agent. As of February 29, 2008, a total of 605,000 shares of unregistered common stock have been sold to seven investors resulting in \$151,250 in gross proceeds. The Placement Agent was paid a sales commission of 10% of the gross proceeds of their firm’s sales of the private placement and a non-accountable expense allowance of 3% of the gross proceeds of their firm’s sales totaling \$23,112.50. Net proceeds were used to meet drilling commitments in the Tuscaloosa project and general and administrative expenses

Commencing on October 19, 2007 and closing on December 28, 2007, Daybreak conducted an unregistered offering of common stock through a private placement under the securities transaction exemption Regulation D Rule 506 of the Securities Act of 1933. Shares were offered at \$0.25 per share to “accredited investors” only as defined in Regulation D under the Securities Act of 1933. The shares were sold directly by Daybreak and no placement agent was involved in the offering. A total of 2,497,000 shares of unregistered common stock were sold to thirteen investors resulting in \$624,250 in gross proceeds. Offering expenses were approximately \$6,500. Net proceeds were used to meet drilling commitments in the Tuscaloosa project and general and administrative expenses.

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During the year ended February 28, 2007, Daybreak conducted a private placement sale of common stock from March 3, 2006 to May 19, 2006 (the "May 2006 Common Stock Private Placement"). Each sale unit consisted of two shares of common stock and one common stock purchase warrant (warrant). The units sold for \$1.50 per unit, with a total of 4,013,602 units sold; resulting in gross proceeds of \$6,020,404 (net proceeds of \$5,188,257 after placement costs).

The Warrants are exercisable for a period of five years after the closing date at an exercise price of \$2.00 per share. Daybreak may call the warrants for redemption if (a) the average of the closing sale price of the common stock is at or above \$3.00 for twenty (20) out of thirty (30) trading days prior to the date the warrants are called, and (b) the warrant shares are registered under the Securities Act. The Warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.99%; the current stock price at date of issuance of \$2.70 per share; the exercise price of the warrants; an expected term of five years; volatility of 112%; and dividend yield of 0.0%. As of February 29, 2008, no subscriber warrants had been exercised.

Bathgate Capital Partners, of Denver, Colorado was the placement agent. Joseph Lavigne, son of Dale B. Lavigne (the Chairman and a director of Daybreak) is an employee of Bathgate Capital Partners. The Placement Agent was paid a sales commission of 10% of the gross proceeds of the private placement and a non-accountable expense allowance of 3% of the gross proceeds totaling \$790,402. Additionally, the Placement Agent was paid a due diligence fee of \$15,000. For every ten units sold, the Placement Agent earned three common stock warrants, two of which are exercisable at \$0.75 per share and one of which is exercisable at \$2.00 per share. The Placement Agent warrants are exercisable for a period of seven years. The placement agent earned 1,204,082 warrants, of which 802,721 are exercisable at \$0.75 per share and were determined to have a fair value of \$2,043,752. The remaining 401,361 warrant shares are exercisable at \$2.00 per share and were determined to have a fair value of \$973,970. The placement agent warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 4.99%; the current stock price at date of issuance of \$2.70 per share; the exercise price of the warrants; an expected term of seven years; volatility of 112%; and dividend yield of 0.0%. As of February 29, 2008, no placement agent warrants had been exercised.

The placement agent warrants have a cashless exercise provision and contain customary anti-dilution provisions. The cashless exercise provision allows for the holder of the warrants to receive a number shares equal to the quotient of a) the product of the number of warrants held and the amount by which Daybreaks market traded stock price exceeds the exercise price of the warrants on the date of exercise, divided by b) the market traded stock price. The anti-dilution provisions permit the adjustment of the number of shares issuable upon exercise of the warrants in the event of stock splits, stock dividends, stock reversals and sales of substantially all of the Company's assets.

Daybreak agreed to register the shares on a "best efforts" basis. If Daybreak was unable to file the registration statement within the filing timeline, Daybreak would have had to issue 4,013,602 additional warrants at an exercise price of the lower of (a) the average closing sale price of its common stock for twenty of the thirty trading days immediately preceding the date the registration statement should have been filed, or (b) \$1.50 per common share. Daybreak did file the registration statement within the filing timeline. No additional warrants were required to be issued.

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In February 2008, Daybreak issued “goodwill” common stock warrants to the participants of the Spring 2006 private placement. The warrants were issued as a goodwill gesture to investors in the two 2006 private placements due to the inability to complete the respective registration statements; recognizing, this was a result of regulatory process delays rather than any fault of the Company. Each participant was offered one “goodwill” warrant for every unit that had been purchased in exchange waiving their rights under the Registration Rights Agreement. On November 6, 2007, the date our Board approved issuing these “goodwill” warrants, the closing price of our stock was \$0.40. As of February 29, 2008, we had received Registration Rights waiver letters from approximately 73% of the participants in this private placement. The warrants will expire on February 14, 2010, have an exercise price of \$0.65 and contain a cashless exercise provision. We have issued 2,998,934 goodwill warrants valued at \$680,238 to these investors. A total of 4,013,602 warrants could be issued. The issued warrants were valued using the Black-Scholes option pricing model. The assumptions used in the Black-Scholes valuation model were: a risk free interest rate of 3.7%; a term of two years; volatility of 121.67%; and dividend yield of 0.0%.

Daybreak evaluated the application of SFAS No. 133 and EITF 00-19 with respect to the conversion feature and the registration rights for consideration of embedded derivatives and concluded that the preferred stock and registration rights instruments did not have embedded derivatives.

The relative fair value of the Common Stock and the Common Stock Purchase Warrants was as follows:

Description	Shares	Relative Fair Value Amount
Common Stock	8,027,206	\$ 4,241,232
Common Stock Purchase Warrants	4,013,602	1,779,172
Total Proceeds		6,020,404
Placement fees		(832,147)
Net Proceeds		\$ 5,188,257

During the fiscal year ended February 28, 2005, Daybreak conducted a private placement sale of common stock from June 7, 2005 through December 19, 2005 (the “December 2005 Common Stock Private Placement”). The shares were sold directly by Daybreak and were offered at \$0.25 per share to accredited investors only. Gross proceeds were \$1,100,000, with net proceeds of \$1,087,500. A total of forty-three investors participated in this private placement. From this offering, 4,400,000 shares of unregistered common stock were issued.

Common Stock for Services

Under SFAS No. 123R the guidelines for recording stock issued for goods or services require the fair value of the shares granted be based on the fair value of the goods or services received or the publicly traded share price of Daybreak’s registered shares on the date the shares were granted (irrespective of the fact that the shares granted were unregistered), whichever is more readily determinable. This position has been further clarified by the recent issuance of SFAS No. 157. Accordingly, Daybreak has elected an early application of these newly enacted guidelines.

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Daybreak has determined that the fair value of all common stock issued for goods or services is more readily determinable based on the publicly traded share price on the date of grant.

During the fiscal year ended February 29, 2008, Daybreak paid for services with 10,000 shares of unregistered common stock valued at \$4,500.

During the fiscal year ended February 28, 2007, Daybreak paid for investor relations and consulting services with 220,000 shares of unregistered common stock valued at \$401,200.

Common Stock Issued for Convertible Debentures and Interest Payable

During the fiscal year ended February 29, 2008, non-related parties converted debentures representing \$25,000 in principal, resulting in 37,169 shares of unregistered common stock being issued to satisfy the principal and interest obligations.

During the fiscal year ended February 28, 2007, non-related parties converted debentures representing \$770,139 in principal, resulting in 1,471,763 shares of unregistered common stock being issued to satisfy the principal and interest obligations.

Common Stock Issued for Oil and Gas Property Interests

Under SFAS No. 123R the guidelines for recording stock issued for goods or services require the fair value of the shares granted be based on the fair value of the goods or services received or the publicly traded share price of Daybreak's registered shares on the date the shares were granted (irrespective of the fact that the shares granted were unregistered), whichever is more readily determinable. This position has been further clarified by the recent issuance of SFAS No. 157. Accordingly, Daybreak has elected an early application of these newly enacted guidelines. Daybreak has determined that the fair value of all common stock issued for goods or services is more readily determinable based on the publicly traded share price on the date of grant.

During the fiscal year ended February 28, 2007, Daybreak purchased oil and gas properties valued at \$420,000 by issuing 150,000 shares of its unregistered common for the 40 Mile Coulee project in Alberta, Canada. On December 8, 2006, Daybreak repurchased these same 150,000 shares for an agreed amount of \$150,000 as part of an agreement to release Daybreak from any further plugging and abandonment liabilities related to this project.

During the fiscal year ended February 28, 2007, Daybreak purchased an additional eight percent (8%) working interest in the Tuscaloosa project in Louisiana from Strike Oil & Minerals, Corp. for \$205,883 in cash and 72,500 shares of unregistered common stock valued at \$108,750.

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NOTE 11 – WARRANTS:

Warrants outstanding and exercisable as of February 28, 2007 are:

Description	Warrants	Exercise Price	Remaining Life (Years)	Exercisable Warrants Remaining
Spring 2006 Common Stock Private Placement	4,013,602	\$ 2.00	4.25	4,013,602
Placement Agent Warrants Spring 2006 PP	802,721	\$ 0.75	6.25	802,721
Placement Agent Warrants Spring 2006 PP	401,361	\$ 2.00	6.25	401,361
July 2006 Preferred Stock Private Placement	2,799,530	\$ 2.00	4.50	2,799,530
Placement Agent Warrants July 2006 Preferred Stock Private Placement	419,930	\$ 1.00	4.50	419,930
Convertible Debenture Term Extension	150,001	\$ 2.00	4.75	150,001
	<u>8,587,145</u>			<u>8,587,145</u>

Warrants outstanding and exercisable as of February 29, 2008 are:

Description	Warrants	Exercise Price	Remaining Life (Years)	Exercisable Warrants Remaining
Spring 2006 Common Stock Private Placement	4,013,602	\$ 2.00	3.25	4,013,602
Placement Agent Warrants Spring 2006 PP	802,721	\$ 0.75	5.25	802,721
Placement Agent Warrants Spring 2006 PP	401,361	\$ 2.00	5.25	401,361
July 2006 Preferred Stock Private Placement	2,799,530	\$ 2.00	3.50	2,799,530
Placement Agent Warrants July 2006 Preferred Stock Private Placement	419,930	\$ 1.00	3.50	419,930
Convertible Debenture Term Extension	150,001	\$ 2.00	3.75	150,001
Convertible Debenture 2 nd Term Extension	112,000	\$ 0.53	1.50	112,000
Convertible Debenture 3 rd Term Extension	90,000	\$ 0.25	1.75	90,000
Spring 2006 PP Goodwill Warrants	2,998,934	\$ 0.65	2.00	2,998,934
July 2006 PP Goodwill Warrants	1,121,267	\$ 0.65	2.00	1,121,267
	<u>12,909,346</u>			<u>12,909,346</u>

During the year ended February 29, 2008, no warrants were exercised. For the fiscal years ended February 29, 2008 and February 28, 2007 there were 12,909,346 and 8,587,145 warrants issued or outstanding respectively. The intrinsic value of all warrants at February 29, 2008 was \$5,400.

During the year ended February 28, 2007, no warrants were exercised. For the year ended February 28, 2006 there were no warrants issued or outstanding. The intrinsic value of all warrants at February 28, 2007 was \$152,517.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

NOTE 12 - INCOME TAXES:

Reconciliation between actual tax expense (benefit) and income taxes computed by applying the U.S. federal income tax rate and state income tax rate to income from continuing operations before income taxes is as follows:

	2008
Computed at U.S. and State statutory rates (40%)	\$ (2,080,244)
Permanent differences	68,415
Changes in valuation allowance	2,011,829
Total	\$ -

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

	2008	2007
Deferred tax assets:		
Net operating loss carryforwards	\$ 2,574,000	\$ 1,734,000
Oil and gas properties	1,745,820	947,800
Warrant expense	373,808	
Less valuation allowance	(4,693,628)	(2,681,800)
Total	\$ -	\$ -

At February 29, 2008, Daybreak had a net operating loss carryforwards for federal and state income tax purposes of approximately \$6,435,000, which will begin to expire, if unused, beginning in 2024. Section 382 Rule will place annual limitations on Daybreak's net operating loss (NOL) carryforward.

The above estimates are based upon management's decisions concerning certain elections which could change the relationship between net income and taxable income. Management decisions are made annually and could cause the estimates to vary significantly.

NOTE 13 - FINAL CLOSING OF SALE OF TUSCALOOSA PROPERTIES SUBSEQUENT TO INITIAL FILING OF FORM 10-KSB:

On January 18, 2008, Daybreak signed a purchase and sale agreement ("PSA") for the sale of its Tuscaloosa project interests for \$8 million in cash. The transaction closed in three tranches; the first closing for \$2 million closed on January 18, 2008; the second closing for \$500,000 occurred on April 30, 2008; and the final closing for \$5.5 million occurred on June 12, 2008 and was subject to customary closing adjustments. The sale includes Daybreak's interests in the Tensas Farms F-1, F-3, B-1, A-1 and F-2 wells; and all of its acreage and infrastructure in the project area. Under terms of the PSA, the effective dates for each closing was January 1, 2008.

As a result of the final closing and the \$5.5 million cash receipts, the conditions that gave rise to the Company's going concern uncertainty have subsequently been resolved.

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

NOTE 14 – RESTATEMENT:

On December 19, 2008, the audit committee of the board of directors of Daybreak Oil and Gas, Inc. (the “Company”) determined that it will be necessary to restate its financial statements for the fiscal year ended February 29, 2008, as filed on Form 10-KSB on May 27, 2008 (the “Restated Period”) to correct for an error in the accounting of the goodwill common stock warrants issued in February 2008 (see also Note 10).

This determination was made after consideration was given to a series of comments made by the Staff of the Securities and Exchange Commission (the “SEC”) regarding certain financial valuation and disclosure items in the Company’s Form 10-KSB/A for the fiscal year ended February 29, 2008. In response to comments and a review by the SEC, the Company determined that it should follow the guidance of Statement of Financial Accounting Standards No. 123R (“FAS 123R”) Share-Based Payment and FSP EITF 00-19-2 Accounting for Registration Payment Arrangements in its accounting treatment of warrants offered by the Company in February 2008 to participants of the two private placement offerings that occurred in 2006.

The restated financial statements reflect the values of the goodwill common stock warrants issued to participants in the July 2006 and Spring 2006 private placements of \$254,283 and \$680,238, respectively as general and administrative expense in the income statement on the basis that these common stock warrants were issued in exchange for the waiver of the investors’ registration rights. Previously, Daybreak had recognized these goodwill common stock warrants as incremental costs related to the above private placements offerings and were debited to additional paid in capital.

The correction of this error affected certain accounts in the balance sheet as of February 29, 2008 and certain line items in the statement of operations, statement of changes in stockholders equity and the statement of cash flows for the year ended February 29, 2008 and from inception through February 29, 2008.

The effects of the correction of the accounting error are summarized as follows:

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

As of February 29, 2008:	As Previously Reported	Adjustments	As Restated
Total current assets	\$ 1,049,217	\$ -	\$ 1,049,217
Oil and gas properties, net of accumulated depletion, successful efforts method	169,521	-	169,521
Assets held for sale	1,634,471	-	1,634,471
Other assets	807,828	-	807,828
Total assets	<u>\$ 3,661,037</u>	<u>\$ -</u>	<u>\$ 3,661,037</u>
Total current liabilities	\$ 316,253	\$ -	\$ 316,253
Other liabilities	119,207	-	119,207
Total liabilities	<u>435,460</u>	<u>-</u>	<u>435,460</u>
Preferred stock	1,298	-	1,298
Common stock	44,294	-	44,294
Additional paid-in capital	21,046,264	934,521	21,980,785
Accumulated deficit	(736,035)	-	(736,035)
Deficit accumulated during the exploration stage	(17,130,244)	(934,521)	(18,064,765)
Total stockholders' equity	<u>3,225,577</u>	<u>-</u>	<u>3,225,577</u>
Total liabilities and stockholders' equity	<u>\$ 3,661,037</u>	<u>\$ -</u>	<u>\$ 3,661,037</u>

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

For the twelve months ended February 29, 2008:	As Previously Reported	Adjustments	As Restated
REVENUE	\$ 366,850	\$ -	\$ 366,850
OPERATING EXPENSES:			
Production costs	326,849	-	326,849
Exploration and drilling	654,765	-	654,765
Depreciation and depletion expense	2,333,571	-	2,333,571
General and administrative	1,729,156	934,521	2,663,677
Total operating expenses	5,044,341	934,521	5,978,862
OPERATING LOSS	(4,677,491)	(934,521)	(5,612,012)
OTHER INCOME AND (EXPENSE)	(22,521)	-	(22,521)
LOSS FROM CONTINUING OPERATIONS	(4,700,012)	(934,521)	(5,634,533)
Income from discontinued operations	433,839	-	433,839
NET LOSS	(4,266,173)	(934,521)	(5,200,694)
Cumulative convertible preferred stock dividend requirement	(395,923)	-	(395,923)
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	\$ (4,662,096)	\$ (934,521)	\$ (5,596,617)
NET LOSS PER COMMON SHARE			
Loss from continuing operations	\$ (0.11)	\$ (0.03)	\$ (0.14)
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING	41,292,659	-	41,292,659

Daybreak Oil and Gas, Inc. (An Exploration Stage Company, Date of Inception March 1, 2005)
Notes to Financial Statements

SUPPLEMENTARY INFORMATION FOR OIL AND GAS PRODUCING ACTIVITIES (UNAUDITED)

All of the Company's operations are directly related to oil and natural gas producing activities located in Alabama, Louisiana, and Texas.

Capitalized Costs Relating to Oil and Gas Producing Activities

	As of February 29 / 28,	
	2008	2007
Proved properties		
Mineral interests	\$ 1,855,994	\$ 2,092,107
Wells, equipment and facilities	3,207,055	2,129,400
Total proved properties	5,063,049	4,221,507
Unproved properties		
Mineral interests	415,357	902,420
Uncompleted wells, equipment and facilities	896,067	1,822,619
Total unproved properties	1,311,424	2,725,039
Less accumulated depreciation, depletion, amortization and impairment	(4,570,481)	(2,393,693)
Net Capitalized Costs	\$ 1,803,992	\$ 4,552,853

Costs Incurred in Oil and Gas Producing Activities

	Twelve Months Ended	
	February 29 / 28,	
	2008	2007
Acquisition of proved properties	\$ 119,235	\$ 428,669
Acquisition of unproved properties	7,043	1,486,901
Development costs	921,334	859,688
Exploration costs	1,264,784	4,241,917
Total Costs Incurred	\$ 2,312,396	\$ 7,017,175

Results of Operations from Oil and Gas Producing Activities

	Twelve Months Ended February 29 / 28,	
	2008	2007
Oil and gas revenues	\$ 1,017,604	\$ 629,346
Production costs	(606,240)	(373,766)
Exploration expenses	(717,265)	(1,196,640)
Depletion, depreciation, and impairment	(2,314,160)	(2,393,693)
Result of oil and gas producing operations before income taxes	(2,620,061)	(3,334,753)
Provision for income taxes	-	-
Results of Oil and Gas Producing Operations	\$ (2,620,061)	\$ (3,334,753)

Proved Reserves

The Company's proved oil and natural gas reserves have been estimated by the certified independent engineering firm, Huddleston & Co., Inc. Proved reserves are the estimated quantities that geologic and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are the quantities expected to be recovered through existing wells with existing equipment and operating methods. Due to the inherent uncertainties and the limited nature of reservoir data, such estimates are subject to change as additional information becomes available. The reserves actually recovered and the timing of production of these reserves may be substantially different from the original estimate. Revisions result primarily from new information obtained from development drilling and production history; acquisitions of oil and natural gas properties; and changes in economic factors. The Company had no proved reserves in fiscal 2006. The fiscal 2008 proved reserves are summarized in the table below:

	Crude Oil and Natural Gas Liquid Bbbs	Natural Gas Mcf
Proved Reserves as of February 29, 2008:		
Beginning of the period	29,425	211,800
Revisions of previous estimates ⁽¹⁾	(15,775)	(104,264)
Extensions and discoveries	9,776	18,148
Production	(6,792)	(49,584)
Sale of minerals in place	(3,522)	(10,600)
End of the period	13,112	65,500

(1) The revisions of previous estimates resulted from two sources. As discussed previously in this 10-KSB/A Amendment No. 2, the F-1 and F-3 wells in the Tuscaloosa project in Louisiana were shut in for the majority of the 2007 – 2008 fiscal year resulting in a marked decline in field performance. This decline then resulted in the previous estimates of proved reserves being decreased.

Additionally, in the Gilbertown Field in Alabama, production costs increased dramatically in comparison to the prior year thereby creating a necessary downward revision of proved reserves because of a higher economic limit. These increased costs were due to recurring workover programs that occurred on existing wellbores.

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserves

The following information is based on the Company's best estimate of the required data for the Standardized Measure of Discounted Future Net Cash Flows as of February 29, 2008 and February 28, 2007 in accordance with SFAS No. 69, "Disclosures About Oil and Gas Producing Activities" which requires the use of a 10% discount rate. This information is not the fair market value, nor does it represent the expected present value of future cash flows of the Company's proved oil and gas reserves.

	February 29 / 28,	
	2008	2007
Future cash inflows	\$ 1,876,287	\$ 3,270,219
Future production costs ⁽¹⁾	(632,786)	(889,817)
Future development costs	-	(170,762)
Future income tax expenses ⁽²⁾	-	-
Future net cash flows	1,243,501	2,209,640
10% annual discount for estimated timing of cash flows	(113,236)	(269,273)
Standardized measure of discounted future net cash flows at the end of the year	<u>\$ 1,130,265</u>	<u>\$ 1,940,367</u>

(1) Production costs include oil and gas operations expense, production ad valorem taxes, transportation costs and general and administrative expense supporting the Company's oil and gas operations.

(2) The Company has sufficient tax deductions and allowances related to proved oil and gas reserves to offset future net revenues.

Future cash inflows are computed by applying year-end prices, adjusted for location and quality differentials on a property-by-property basis, to year-end quantities of proved reserves, except in those instances where fixed and determinable price changes are provided by contractual arrangements at year-end. The discounted future cash flow estimates do not include the effects of the Company's derivative instruments, if any. See the following table for average prices.

	February 29 / 28,	
	2008	2007
Average crude oil price per Bbl	74.89	\$ 65.10
Average natural gas price per Mcf	7.63	\$ 6.62

Future production and development costs, which include dismantlement and restoration expense, are computed by estimating the expenditures to be incurred in developing and producing the Company's proved crude oil and natural gas reserves at the end of the year, based on year-end costs, and assuming continuation of existing economic conditions.

Future income tax expenses are computed by applying the appropriate year-end statutory tax rates to the estimated future pretax net cash flows relating to the Company's proved crude oil and natural gas reserves, less the tax bases of the properties involved. The future income tax expenses give effect to tax credits and allowances, but do not reflect the impact of general and administrative costs and exploration expenses of ongoing operations relating to the Company's proved crude oil and natural gas reserves.

Sources of Changes in Discounted Future Net Cash Flows

Principal changes in the aggregate standardized measure of discounted future net cash flows attributable to the Company's proved crude oil and natural gas reserves, as required by SFAS No. 69, at year end are set forth in the table below.

	Twelve Months Ended	
	February 29 / 28,	
	2008	2007
Standardized measure of discounted future net cash flows at the beginning of the year	\$ 1,940,367	\$ -
Extensions, discoveries and improved recovery, less related costs	644,889	1,806,060
Revisions of previous quantity estimates	(1,559,345)	-
Changes in estimated future development costs	(185,701)	-
Purchases (sales) of minerals in place	(330,401)	389,887
Net changes in prices and production costs	283,362	-
Accretion of discount	194,037	-
Sales of oil and gas produced, net of production costs	(411,365)	(255,580)
Development costs incurred during the period	356,463	-
Change in timing of estimated future production and other	197,959	-
Net change in income taxes	-	-
Standardized measure of discounted future net cash flows at the end of the year	<u>\$ 1,130,265</u>	<u>\$ 1,940,367</u>

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 8A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures.

As of the end of the reporting period, February 29, 2008, an evaluation was conducted by Daybreak management as to the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act"). Such disclosure controls and procedures are designed to insure 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 Securities & Exchange Commission rules and forms. Additionally, it is vital that such information is accumulated and communicated to our management in a manner to allow timely decisions regarding required disclosures.

Based upon that evaluation, our management concluded that our financial and disclosure controls needed improvement and were not effective as of February 29, 2008.

Management's Report on Internal Control Over Financial Reporting.

Management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rule 13a-15(f). The Company's internal control over financial reporting is a process designed 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.

Because of the inherent limitations due to, for example, the potential for human error or circumvention of controls, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this evaluation, management concluded that the Company's internal control over financial reporting was not effective as of February 29, 2008. Material weakness identified included:

- The Company's corporate governance and disclosure controls and procedures do not provide reasonable assurance that material transactions are timely and accurately reported in Periodic Reports that we file with the Securities and Exchange Commission.
- Our 10-KSB report for the fiscal year ended February 28, 2007, should have been filed on May 29, 2007. We were unable to complete the 10-KSB in the time allotted because the restatement of our previously filed financial statements was not completed. Consequently we filed a 12b-25 "Notification of Late Filing" report, believing that we would complete the restatement and audit process within the filing extension period. We were not successful in meeting that goal. On July 2, 2007, our stock was dropped from being quoted on the OTC Bulletin Board market to the OTC pink sheet market.

- Our first quarter 10-QSB report for the fiscal year ended February 29, 2008 should have been filed on July 16, 2007. We were not successful in making this filing deadline because the audit of our prior fiscal year ended February 28, 2006 was not completed.
- Subsequent to these filing delays and completion of the audit of our prior year financial statements, we were able to complete our late filings and fulfill all other requirements allowing Daybreak to return to the OTC Bulletin Board.
- Due to the level of administrative staff at the Company during the past fiscal year, certain beneficial control methods were not available for implementation. This was especially true when evaluating an effective separation of duties and responsibilities in the corporate office as it relates to financial reporting, general accounting processes, and information technology security and controls.

Pursuant to Regulation S-B filers:

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

Changes in Internal Control.

As a result of our evaluations described above, the Company has initiated the changes described below in our internal control over financial reporting during the quarter ended February 29, 2008, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

- We have changed our Corporate Governance structure via the introduction of several new corporate charters and company wide procedures along with a change in the composition of the Board of Directors to be more independent.
- We have revised our operating procedures relating to preparation and issuance of financial reports and the timely disclosure of all required SEC filings. The changes include a defined quarter end closing schedule and more timely and detailed review by management and the Board of Directors.
- We have added changes to our management team to increase our industry expertise and increased the administrative staff available to assist in the more timely preparation of all required reporting documents.
- We have made operating and financial changes to our day to day activities to improve the segregation of duties at the Company with the intent to add more control around the authorization of expenditures and payments on behalf of the company.

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.

ITEM 8B. OTHER INFORMATION

None

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Information regarding the Ethical Business Conduct Policy Statement and the Code of Ethics for Senior Financial Officers is described in the introductory pages of this Annual Report under the caption "Website / Available Information." The information required by Item 9 that relates to our directors and executive officers is incorporated by reference from the information appearing under the captions "Election of Directors," "Executive Management," "Corporate Governance," "Section 16(a) Beneficial Ownership Reporting and Compliance" and "Other Information" in our definitive proxy statement or in an amendment to this Annual Report on Form 10-KSB/A that is to be filed with the SEC pursuant to the Exchange Act within 120 days of the end of our fiscal year on February 29, 2008.

ITEM 10. EXECUTIVE COMPENSATION

The information required by Item 10 that relates to compensation of our principal executive officers and our directors is incorporated by reference from the information appearing under the captions "Compensation Discussion and Analysis" and "Director Compensation" in our definitive proxy statement or in an amendment to this Annual Report on Form 10-KSB/A that is to be filed with the SEC within 120 days of the end of our fiscal year on February 29, 2008. In addition and in accordance with Item 402(a)(8) of Regulation S-K, the information contained in our definitive proxy statement or a Form 10-KSB/A under the subheading "Report of the Compensation Committee of the Board of Directors" shall not be deemed to be filed as part of, or incorporated by reference into, this Annual Report.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 11 that relates to the ownership of securities by management and others is incorporated by reference from the information appearing under the caption "Security Ownership" in our definitive proxy statement or in an amendment to this Annual Report on Form 10-KSB/A that is to be filed with the SEC within 120 days of the end of our fiscal year on February 29, 2008.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by Item 12 that relates to business relationships and transactions with our management and other related parties is incorporated by reference from the information appearing under the captions "Related Party Transactions," and "Transactions Between the Company and Managements" in our definitive proxy statement or in an amendment to this Annual Report on Form 10-KSB/A that is to be filed with the SEC within 120 days of the end of our fiscal year on February 29, 2008.

ITEM 13. EXHIBITS

The following Exhibits are filed as part of the report:

- 3.01 Articles of Incorporation, as amended⁽¹⁸⁾
- 3.02 Amended and Restated Bylaws⁽¹⁶⁾
- 4.01 Registration statement of securities⁽⁴⁾
- 4.02 Designations of Series A Convertible Preferred Stock (filed as Articles of Amendment to the Articles of Incorporation of Daybreak Oil & Gas, Inc. dated June 30, 2006 and filed as part of Exhibit 3.01 herewith.)
- 10.01 Quitclaim mining deed with Silver Crown Mining of mineral rights in Idaho⁽¹²⁾
- 10.02 Agreement with Crosspoint Holdings, Inc. for the purchase of Series A Preferred Stock⁽¹⁾
- 10.03 Consulting Agreement with 413294 Alberta Ltd. effective March 1, 2005⁽¹⁵⁾
- 10.04 Consulting Agreement with AnMac Enterprises effective March 1, 2005⁽¹⁵⁾
- 10.05 Consulting Agreement with Eric Moe effective March 1, 2005⁽¹⁵⁾
- 10.06 Expiration of Series A Stock Purchase Agreement with Crosspoint Holdings, Inc.,⁽²⁾
- 10.07 Drilling agreement with MPG Petroleum for Ginny South project.⁽³⁾
- 10.08 Agreement with MPG Petroleum to join land bank for Pearl Prospect⁽³⁾
- 10.09 Consulting agreement with Summitt Ventures for management services⁽³⁾
- 10.10 Development agreement with Chicago Mill Joint Venture for Louisiana project⁽¹²⁾
- 10.11 Prospect review and non-competition agreement for California project⁽¹²⁾
- 10.12 Joint Venture Agreement with Nomad Hydrocarbons, Ltd. for California project⁽¹²⁾
- 10.13 Development agreement with Oracle Operating Co. for Texas project⁽¹²⁾
- 10.14 Prospect review agreement for California project⁽¹²⁾
- 10.15 Development agreement with Vision Exploration for Krotz Springs 3D Prospect⁽¹²⁾
- 10.16 Farmout agreement with Big Sky Western Canada for well in Alberta, Canada⁽¹²⁾
- 10.17 Development agreement with Vision Exploration for prospect in Louisiana⁽¹²⁾
- 10.18 Subscription agreement and letter of investment intent, March 2006 private placement⁽⁵⁾
- 10.19 Warrant for the purchase shares of common stock, March 2006 private placement⁽⁵⁾
- 10.20 Registration rights agreement, March 2006 private placement⁽⁵⁾
- 10.21 Pipeline license agreement for Tuscaloosa project in Louisiana⁽¹²⁾
- 10.22 Subscription agreement and letter of investment intent, July 2006 private placement⁽¹⁵⁾
- 10.23 Warrant for the purchase shares of common stock, July 2006 private placement⁽¹⁵⁾
- 10.24 Registration rights agreement, July 2006 private placement⁽¹⁵⁾
- 10.25 Development agreement with Frank Davis Exploration for prospect in Louisiana⁽¹²⁾
- 10.26 Agreement for refurbishing and operating of drilling rig⁽⁶⁾
- 10.27 Consulting Agreement with Jeffrey Dworkin dated August 1, 2006⁽¹⁵⁾
- 10.28 Office Rent Agreement with Terrence Dunne & Associates dated August 1, 2006⁽¹⁵⁾
- 10.29 Consulting Agreement with Michael Hooper dated August 3, 2006⁽¹⁵⁾
- 10.30 Purchase of additional mineral interest in Tuscaloosa project in Louisiana⁽⁷⁾
- 10.31 Farmout agreement with Monarch Gulf Exploration, Inc.⁽⁸⁾
- 10.32 Oil and gas lease with Anadarko E&P Company, L.P.⁽⁹⁾
- 10.33 Drilling contract with Energy Drilling for two wells in Louisiana⁽¹¹⁾
- 10.34 Consulting Agreement with Tim Lindsey effective January 2, 2007⁽¹⁵⁾
- 10.35 Consulting Agreement with 413294 Alberta Ltd. effective March 1, 2007⁽¹⁵⁾
- 10.36 Consulting Agreement with Jeffrey Dworkin effective March 1, 2007⁽¹⁵⁾
- 10.37 Consulting Agreement with Michael Hooper effective March 1, 2007⁽¹⁵⁾
- 10.38 Employment Agreement with Eric Moe, CEO effective March 1, 2007⁽¹⁵⁾
- 10.39 Employment Agreement with Bennett Anderson effective March 1, 2007⁽¹⁵⁾
- 10.40 Employment Agreement Thomas Kilbourne effective March 1, 2007⁽¹⁵⁾

- 10.41 Office Rent Agreement with Terrence Dunne & Associates effective May 1, 2007⁽¹⁵⁾
- 10.42 Seismic Option Farmin Agreement with Chevron U.S.A. ⁽¹³⁾
- 10.43 Joint Development Participation Agreement for Tuscaloosa project in Louisiana ⁽¹⁴⁾
- 10.44 Definitive Purchase and Sale Agreement with Lasso Partners, LLC⁽¹⁸⁾
- 10.45 Letter of Agreement to Amendment of Purchase and Sale Agreement with Lasso Partners,LLC⁽¹⁷⁾
- 10.46 Warehousing Line of Credit Promissory Note and Personal Guaranty⁽¹⁸⁾
- 10.47 Purchase of Tuscaloosa interest from Kirby Cochran ⁽¹⁸⁾
- 10.48 Purchase of Tuscaloosa interest from 413294 Alberta Ltd. (Robert N. Martin)⁽¹⁸⁾
- 10.49 Purchase of Tuscaloosa interest from Tempest Energy, Inc (Eric L. Moe)⁽¹⁸⁾
- 10.50 Letter of Agreement on North Shuteston Assignment of Interest⁽¹⁸⁾
- 14.01 Ethical Business Conduct Policy Statement⁽¹⁶⁾
- 14.02 Code of Ethics for Senior Financial Officers⁽¹⁶⁾
- 16.01 Change in Certifying Accountant⁽¹⁰⁾
- 23.1 [Consent of Huddleston & Co., Inc.](#) ⁽¹⁹⁾
- 31.1 [Certification of principal executive and principal financial officer as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#) ⁽¹⁹⁾
- 32.1 [Certification of principal executive and principal financial officer as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#) ⁽¹⁹⁾
- 99.1 Audit Fee Pre-Approval Policy (April 2008)⁽¹⁸⁾

- (1) Previously filed as exhibit to Form 8-K on November 5, 2004, and incorporated by reference herein.
- (2) Previously filed as exhibit to Form 8-K on April 7, 2005, and incorporated by reference herein.
- (3) Previously filed as exhibit to Form 10-KSB on June 15, 2005, and incorporated by reference herein.
- (4) Previously filed as exhibit to Form S-8 on August 19, 2005, and incorporated by reference herein.
- (5) Previously filed as exhibit to Form SB-2 on July 18, 2006, and incorporated by reference herein.
- (6) Previously filed as exhibit to Form 8-K on September 6, 2006, and incorporated by reference herein.
- (7) Previously filed as exhibit to Form 8-K on September 28, 2006, and incorporated by reference herein.
- (8) Previously filed as exhibit to Form 8-K on October 26, 2006, and incorporated by reference herein.
- (9) Previously filed as exhibit to Form 8-K on November 7, 2006, and incorporated by reference herein.
- (10) Previously filed as exhibit to Form 8-K on November 15, 2006, and incorporated by reference herein.
- (11) Previously filed as exhibit to Form 8-K on November 17, 2006, and incorporated by reference herein.
- (12) Previously filed as exhibit to Form SB-2/A on December 28, 2006, and incorporated by reference herein.
- (13) Previously filed as exhibit to Form 8-K on July 16, 2007, and incorporated by reference herein.
- (14) Previously filed as exhibit to Form 8-K on July 20, 2007, and incorporated by reference herein.
- (15) Previously filed as exhibit to Form 10-KSB on September 21, 2007, and incorporated by reference herein.
- (16) Previously filed as exhibit to Form 8-K on April 9, 2008, and incorporated by reference herein.
- (17) Previously filed as exhibit to Form 8-K on May 2, 2008, and incorporated by reference herein.
- (18) Filed with Original Form 10-KSB filed on May 27, 2008.
- (19) Filed herewith.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 that relates to services provided by our registered public accounting firm and the fees incurred for services provided during fiscal years 2008 and 2007 is incorporated by reference from the information appearing under the captions "Fees Billed by Independent Public Accountants" in our definitive proxy statement or in an amendment to this Annual Report on Form 10-KSB/A that is to be filed with the SEC within 120 days of the end of our fiscal year on February 29, 2008.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) 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
Date: January 14, 2009

January 13, 2009

Daybreak Oil and Gas, Inc.
601 W. Main Ave.
Suite 1012
Spokane, WA 99201

Re: Securities and Exchange Commission
Form 10-KSB (Amended)
Consent of Independent Engineer

Ladies and Gentlemen:

We hereby consent to the use of the name Huddleston & Co., Inc., to references to Huddleston & Co., Inc. an independent engineering firm, and to the inclusion of information contained in our reports as of February 29, 2008, in the Annual Report on Form 10-KSB on May 27, 2008, as amended on Form 10-KSB/A and Form 10-KSB/A No. 2.

Very truly yours,

HUDDLESTON & CO., INC.

By: /s/ GREGORY S. FLOYD, P.E.

Name: Gregory S. Floyd, P.E.

Title: Vice President

Exhibit 31.1

Certification

I, James F. Westmoreland, certify that:

- (1) I have reviewed this Amendment No. 2 to Form 10-KSB filed on Form 10-KSB/A 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 small business issuer as of, and for, the periods presented in this report;
- (4) The small business issuer'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 15d-15(f)) for the small business issuer 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 small business issuer, 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 small business issuer'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 small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
- (5) The small business issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer'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 small business issuer'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 small business issuer's internal control over financial reporting.

Date: January 14, 2009

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)

**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 Amendment No. 2 filed on Form 10-KSB/A to the Annual Report of Daybreak Oil and Gas, Inc., (the "Company") on Form 10-KSB for the period ending February 29, 2008, 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 certifies, 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: January 14, 2009

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)