

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis, as provided by the management of Emerald Bay, should be read in conjunction with the December 31, 2002 Financial Statements.

Results of Operations

| | 2002 | 2001 |
|-------------------------------------|-------------|-----------|
| Petroleum and natural gas revenue | \$847, 270 | \$945,802 |
| Net income (loss) | \$(231,863) | \$288,842 |
| Earnings (loss) per common share | \$(0.036) | \$0.045 |
| Natural gas selling price (\$/mcf) | \$3.87 | \$5.46 |
| Production (BOE/d) | 122 | 88 |
| Proven and probable reserves (mBOE) | 297 | 336 |

Revenue

Petroleum and natural gas revenue decreased to \$847,270 for the year ended December 31, 2002 compared to \$945,802 reported for the year ended December 31, 2001.

A large swing in commodity prices occurred during the year with spot natural gas pricing averaging \$3.60/mcf in the first quarter declining to under \$2.00/mcf by mid summer to a December price exceeding \$5.00/mcf. Natural gas price increases have continued into 2003.

Operating Expenses

Total operating expenses for the year were \$189,265 compared to \$207,442 for 2001. Emerald Bay's natural gas is processed by third parties and all third-party processing charges have been included.

General and Administration

General and administrative expenses for the year increased from \$407,963 in 2001 to \$634,583 in 2002. There were two main factors that generated the higher general and administrative costs in 2002. The company has been involved in litigation surrounding the patent associated with the Lateral Drainhole Drilling Tool for the past 3 years. We

felt it was time to take a much more aggressive approach to resolve this matter. This aggressive approach was a major contributor to the escalation of the general and administrative costs for 2002 – mainly due to above-normal one time professional and consulting fees. In Q1 of 2003 this approach successfully ended over 3 years of litigation that has been a thorn in the side of this company during that period. We expect these fees to decrease substantially in 2003 as the lawsuit has now been settled. Additionally, after changing auditors in 2001, additional fees were also expended in re-auditing the financials of years 1999 and 2000. Again, we feel these one-time expenditures are not the norm and 2003 will see significant decreases in accounting fees.

Net Income (loss)

Net loss for the year ended December 31, 2002 was \$231,863. This was a decrease from a net income of \$288,842 reported for the year ended December 31, 2001. Lower natural gas prices and higher general and administration as discussed accounted for the majority of the reduction in net income.

Future Outlook

Fluctuating natural gas prices and negotiating a settlement on the Lateral Drainhole Drilling Tool were key issues surrounding 2002. While we recognize 2002 as a year of challenges, we also realize that overcoming those challenges has helped set the stage for high-impact growth as we work to strengthen our business. Going forward, our growth will be managed properly to protect profitability.

Exploration and Production in 2003

Emerald Bay's business plan is well supported by favorable commodity prices and projected strong demand for natural gas over the next several years. The company's experienced management and technical teams, and its solid base of quality assets derived from internally-generated prospects, create a strong platform for growth during the next 12 to 18 months. In addition, early stage work is underway on projects designed to deliver high-impact growth over the longer-term. With the proper financing, Emerald Bay is in its strongest position ever to deliver a year of significant growth in production, reserves, cash flow and net income.

- FOCUSED WESTERN CANADIAN OPERATIONS
- GROWTH THROUGH THE DRILL-BIT VS. ACQUISITION
- INTERNALLY GENERATED PROSPECTS
- GOOD GEOLOGY SUPPORT ON UNDEVELOPED LAND
- GAS-FOCUSED LAND PORTFOLIO
- EXCELLENT MULTILATERAL OPPORTUNITIES
- SAGD AND CBM DRILLING METHODOLOGY EXPERTISE
- LOW-RISK SOLID-RETURN PROSPECTS

Research and Development in 2003

The R&D activities during 2002 continued to center around the Lateral Drainhole Drilling tool (LDD). Negotiating a settlement of the intellectual property was paramount in our 2002 strategy. The settlement became a reality in Q1 of 2003. This sets the stage for a rapid-pace development effort in 2003.

Gibson C. Scott has recently been appointed to the Board of Directors, and will also serve in a consulting role to the company. Mr. Scott's 29+ years of service industry expertise in the acquisition, design, development, and deployment of down-hole tools will be extremely valuable to the Company as it moves forward with the LDD technology.

To understand the potential of the tool you must first understand the need that exists within the industry. There is a large number of existing oil and gas wells that have significant damage around the well bore. This damage can be caused by a number of factors including, drilling fluid invasion, plugged pores resulting in decreased permeability, and even cement build-up in a potentially productive zone. An operator's problem begins with the fact that they must get past the damage and into the hydrocarbon-producing area of the formation. We at Emerald Bay believe that the LDD tool will provide the operator with a low-cost, efficient solution to their problem.

Although this development effort has taken longer than we originally anticipated, we remain optimistic about the future of the LDD tool. The process of taking an idea in conceptual form and creating a commercially-viable product can oftentimes experience unexpected delays. We take any delays very seriously and work hard to implement detailed development and programmatic guidelines that clearly define the path to a commercially-viable product.

While development delays and issues can sometimes impact on our share price in the near-term, we will continue to work the development and intellectual property issues without losing sight of our underlying corporate strategy. We will continue to invest in the people, ideas, and technologies that we believe will make us successful in the long run.

- RAPID-PACED DEVELOPMENT THROUGH Q4 2003
- WORK WITH DEVELOPMENT PARTNER TO INSURE SUCCESS
- APPLY FOR ADDITIONAL LABOR FUNDS THROUGH NRC
- CONTINUE TO FOCUS ON ALTERNATIVE ENERGY SOURCE APPLICATIONS FOR LDD
- PRODUCTION PROTOTYPE BY Q4 2003

Statements in this management's discussion and analysis relating to matters that are not historical facts are forward-looking statements. Such forward-looking statements involve known and unknown risks and uncertainties which may cause the actual results, performances or achievements of the Company to be materially different from any future results implied by such forward-looking statements. Such factors include fluctuations in the market for oil and gas related products and services, political and economic conditions in countries where the Company does business, the ability of the Company to attract and retain key personnel, and other factors described in the Company's filings.