



Emerald Bay Energy

EMERALD BAY ENERGY, INC.

MANAGEMENT DISCUSSION AND ANALYSIS

**FOR THE YEAR ENDED
DECEMBER 31, 2004**

APRIL 15, 2005

MANAGEMENTS' DISCUSSION AND ANALYSIS

The following discussion and analysis of financial information and related data concerning Emerald Bay Energy, Inc. is reported in Canadian dollars and the financial data presented has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), and should be read in conjunction with the audited financial statements for the year ended December 31, 2004.

Natural gas reserves and volumes are converted to barrels of oil equivalent (boe) on the basis of 6 thousand cubic feet (mcf) of gas to 1 barrel (bbl) of oil. Boe's may be misleading, particularly if used in isolation. A boe conversion of 6 mcf to 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not necessarily represent a value equivalency at the wellhead.

Information which is contained herein contains estimates and assumptions which management is required to make concerning future events, and may constitute forward-looking statements under applicable securities laws. Forward-looking statements include plans, expectations, estimates, forecasts and other comments that are not statements of fact. Although such expectations are viewed as reasonable by the Company, no assurance can be given that such expectations will be realized. Such forward-looking statements are subject to risks and uncertainties and may be based on assumption that may cause actual results to differ materially from those implied herein, and therefore are expressly qualified in their entirety by this cautionary statement.

OVERVIEW

Emerald Bay Energy, Inc. ("Emerald Bay" or the "Company") is engaged in the business of exploration, development and production of crude oil, natural gas and natural gas liquids. As a strategic initiative, the Company is also developing technology for down-hole drilling applications, targeting marginal-producing and abandoned wells (the LDD technology). In a February 25, 2005 press release, the Company announced plans to transfer the LDD technology to a subsidiary with the intention of creating an independent, privately owned company with its own management and capital structure. The corporation anticipates that it will not finance development of the LDD, or the general administrative expenses associated with the LDD, past June 30, 2005. In addition, the Company has initiated a review of general and administrative costs and a reorganization of its management group in order to align its organizational structure with its expected future cash flow and activity levels. At the conclusion of this restructuring, Emerald Bay will be a pure oil and gas exploration and production business model with a non-controlling equity interest in an oilfield services technology company.

During fiscal 2004, the Company achieved success on both fronts. The LDD technology was advanced through the expenditure of significant funds on the development of the various components of the tool. This work was supported by a National Research Council IRAP grant of \$145,000, received during 2004.

In addition, as discussed below, a successful drilling program was undertaken in the latter half of 2004. The results of that drilling program are partially reflected in the increase in year-end oil and gas reserves of the Company (further testing of the wells indicates larger reserves than estimated at December 31) and the Company anticipates future increases in production once the wells are tied-in and producing.

For the three months ended For the twelve months ended

	Dec 31 2004 (\$)	Dec 31 2003 (\$)	Dec 31 2004 (\$)	Dec 31 2003 (\$)
Revenues (before royalties)	328,906	315,308	1,216,492	1,324,794
Research and Development costs	(187,112)	(237,242)	(440,880)	(275,256)
Net income (loss)	(465,359)	(263,519)	(981,108)	(297,852)
Net income (loss) per share (basic and diluted)	(0.04)	(0.04)	(0.08)	(0.04)
Total assets	2,954,212	2,126,761	2,954,212	2,126,761
Secured term debt	360,000	-	360,000	-

After completing a \$ 1,339,000 flow-through financing in the 4th quarter of 2003, the Company embarked on an exploration program that included data collection, geophysical analysis and drilling during 2004. Emerald Bay was involved in the drilling of 6 gross wells in Alberta during the year. Two coal bed methane (CBM) wells were drilled at Clive and while one was tied in at year-end, it had been shut in by the gas plant operator. Alternative delivery options are being investigated before the second well is tied in and further drilling commenced on the remaining 6 wells in the program. A well was drilling at year-end in the Twining area and testing subsequent to year-end suggests significant reserve and production potential. The Company plans to tie-in the well after spring breakup. In addition, during the fourth quarter, a Belly River gas well was drilled in the Clive area. The Company has tested the well and is awaiting the end of spring breakup to tie the well in for production. At Edson, a Cardium well was cased and cemented and various completion and production alternatives are being investigated in order to optimize production potential from this tight formation. At Conrad, Alberta testing operations on a directional well were terminated after failing to encounter economic quantities of oil or natural gas. The Company will evaluate the remaining farmout lands to determine if an option well is warranted.

Management expects to increase the Company's reserves, production, and cash flow into 2006 as a result of the Company's 2005 drilling programs in Alberta. Management also intends to intensify its pursuit of further acquisition, exploitation and exploration prospects with a view to identifying and capturing opportunities that have the potential to provide an additional core area for the Company.

The development of the LDD tool continues at the Company's testing facility in Calgary. Significant progress has been achieved in critical components as we move this tool closer to a commercial product. The LDD tool will enable the Company and other oil and gas producing firms to optimize the performance of their wells by getting beyond formation damage and enhance production in a cost-effective manner.

RESERVES

Emerald Bay engaged Gilbert Lausten Jung Associates Limited (GLJ) to perform an independent reserve evaluation prepared in accordance with NI 51-101 for the Canadian properties. The Company also engaged Paul R. Clevenger Petroleum Engineering Consultants to perform an evaluation of the Company's US oil property.

At the end of 2004 (based on GLJ forecast pricing), total proved plus probable reserves in Canada increased 42% over the previous year to 343 thousand boe from 239 thousand boe, and the net present value of proved plus probable reserves (before tax, discounted at 10%) increased 86% to \$3.9 million as at December 31, 2004 from \$2.1 million as at December 31, 2003. The US reserve continuity is shown separately as it was prepared under US evaluation rules and may not be comparable to the Canadian report. The US reserves are not material to the Company's production or reserve value.

	Dec 31 2003	2004 Adds Revisions	2004 Production	Dec 31 2004
Cdn Crude oil &NGL – bbl	49,600	(3,650)	(3,950)	42,000
Cdn Natural gas – mcf	1,135,500	816,000	(138,500)	1,813,000
Total Boe - Canada	239,000	131,000	(27,000)	343,000
US Crude oil	15,000	(2,000)	(1,900)	11,100

Subsequent to the date of the GLJ report, Emerald Bay has received updated evaluations as of March 31, 2005 for the Clive and Twining properties as prepared by Proven Reserves Exploitation Ltd. The Clive and Twining upside review reflects production testing activity not considered in the GLJ report. Based on these latter reports, the incremental proved plus probable reserves is currently in excess of 316 thousand boe and \$1.2 million over the year-end results of the GLJ report.

Net present value of proved plus probable reserves (before tax, discounted at 10%) increased 143% to \$5.1 million as at March 31, 2005 from \$2.1 million as at December 31, 2003. The companies CBM pilot project in Alberta as well as the Companies Texas properties are not reflected in these values.

DETAILED REVIEW OF FINANCIAL RESULTS

Net Earnings and Cash Flow

	For the three months ended		For the twelve months ended	
	Dec 31 2004 (\$)	Dec 31 2003 (\$)	Dec 31 2004 (\$)	Dec 31 2003 (\$)
Net earnings (loss)	(465,359)	(263,519)	(981,108)	(297,852)
Per share	(0.04)	(0.04)	(0.08)	(0.04)
Cash flow used from operations	(87,581)	(346,127)	(618,095)	(251,170)
Per share	(0.01)	(0.05)	(0.05)	(0.04)

The Company has recorded a net loss of \$981,108 for the twelve months ended December 31, 2004, compared to a net loss of \$297,852 for the period ended December 31, 2003. Substantially increased exploration activities and a stepped up research and development program, led to a significant increase in general and administration costs to support those efforts. In addition, the

potential liability arising on the Alberta Royalty Tax Credit (ARTC) dispute with the Alberta government was booked in 2004 and combined, these factors accounted for the majority of the increase in the net loss in 2004. This dispute is in relation to the 1998-2001 Alberta Corporate tax returns for which Alberta Revenue has issued Notices of Reassessment to disallow claims for ARTC. The Company disagrees with the assessments and the Company has filed Notices of Objection but has recorded \$280,305 in the 2004 financial statements for the repayment of these ARTC's and related interest. The outcome of this matter is not determinable at this time.

Revenue

	For the three months ended		For the twelve months ended	
	Dec 31	Dec 31	Dec 31	Dec 31
	2004	2003	2004	2003
	(\$)	(\$)	(\$)	(\$)
Oil and NGLs	73,416	46,151	249,871	226,745
Per barrel	49.24	31.92	42.64	35.09
Natural gas	255,490	220,145	966,622	1,098,049
Per mcf	7.20	5.72	6.98	6.86
Total gross revenue	328,906	266,296	1,216,492	1,324,794
Per boe	44.43	33.86	42.35	39.94

Sales Volumes

	For the three months ended		For the twelve months ended	
	Dec 31	Dec 31	Dec 31	Dec 31
	2004	2003	2004	2003
Crude oil – barrels per day	7	6	6	6
Natural gas – mcf per day	385	419	376	439
NGLs – barrels per day	9	10	10	12
BOE – barrels per day	80	85	79	91

Gross revenue decreased in 2004 as compared to 2003, as sales volumes decreased due to natural declines to 79 boe's per day from 91 boe's per day. Emerald does not currently have any hedges in place.

Royalties

	For the three months ended		For the twelve months ended	
	Dec 31	Dec 31	Dec 31	Dec 31
	2004	2003	2004	2003
	(\$)	(\$)	(\$)	(\$)
Total royalties	65,088	78,289	203,977	323,628
Per boe	8.84	10.01	7.07	9.74
Percentage of revenue	19.8%	24.8%	16.8%	24.4%

Royalties for the twelve months ended December 31, 2004 decreased due to the decrease in total revenue as described above. Royalties decreased as a percentage of revenue due to the price sensitivity of the Company's royalties.

Production Expense

	For the three months ended		For the twelve months ended	
	Dec 31 2004 (\$)	Dec 31 2003 (\$)	Dec 31 2004 (\$)	Dec 31 2003 (\$)
Total production expenses	448	138,981	240,072	284,526
Per boe	0.06	17.77	8.36	8.57
Percentage of revenue	0.14%	44.1%	19.7%	21.5%

Production expenses decreased on a per boe basis to \$8.36 from \$8.57 in 2003 but remained fairly consistent. The last quarter of 2004 included several adjustments from other operators to prior quarters operating cost to reflect actual results.

General and administrative expenses

	For the three months ended		For the twelve months ended	
	Dec 31 2004 (\$)	Dec 31 2003 (\$)	Dec 31 2004 (\$)	Dec 31 2003 (\$)
General and administrative expense	125,447	128,176	938,758	672,805

In order to carry out the increased activity levels resulting from the company's five year plan, the company substantially increased staffing levels and consulting services relating to exploration activities and research and development. Additionally, new regulatory requirements have increased administrative expense. Furthermore, certain one time costs of approximately \$75,000 relating to payments in 2004 in recognition of prior years services have also added to increased general and administrative expenses for the period. The company does not capitalize any administrative costs. The Company expects these costs will decrease significantly once the LDD project is transferred to a new company as Emerald Bay will no longer be required to support those activities.

Research and development expenses

	For the three months ended		For the twelve months ended	
	Dec 31 2004 (\$)	Dec 31 2003 (\$)	Dec 31 2004 (\$)	Dec 31 2003 (\$)
Research and development expenditures	187,112	237,242	440,880	275,256

Research and development expenses increased substantially in the period ended December 31, 2004, compared to the period ended December 31, 2003. In addition to increased consulting services the Company has employed two persons in its efforts to complete development of the LDD technology. The Company increased its development efforts substantially in 2004 after settlement of the intellectual property litigation in 2003. Such activity was supported by an IRAP grant of \$145,000 which was received in 2004.

Significant progress has been made on the LDD tool and in early 2005 successful Alpha tests of a prototype tool were completed. This milestone is expected to allow the Company to attract direct participation in the tool by investors interested in bringing the tool to a commercial status. In order to position itself for this possibility, the Company announced its intention to transfer the LDD technology to a newly formed subsidiary in order to create an independent company with its own management and capital structure.

Depletion, depreciation and site restoration expense

	For the three months ended		For the twelve months ended	
	Dec 31 2004 (\$)	Dec 31 2003 (\$)	Dec 31 2004 (\$)	Dec 31 2003 (\$)
Depletion, depreciation and amortization	87,348	45,970	195,985	115,511
Asset Retirement Obligation – Accretion	2,635	(2,574)	10,540	4,053
Total	89,983	43,396	206,525	119,564

Depletion, depreciation and amortization increased in 2004 versus 2003 due to significantly higher capital costs which are being amortized over a reserve base as determined from the year end engineering review of the Company's properties. The engineering review does not fully incorporate the results of the 2004 drilling program as certain wells had not been tested in time for the engineering review process. Accretion increased in 2004 from 2003 due to the ownership of an increased number of oil and natural gas wells and related facilities in 2004.

Taxes

	For the three months ended		For the twelve months ended	
	Dec 31 2004 (\$)	Dec 31 2003 (\$)	Dec 31 2004 (\$)	Dec 31 2003 (\$)
Future income tax expense (recovery)	-	(130,122)	(146,016)	(77,000)

The future tax recovery in 2003 and 2004 is due in part to the loss reported in each year and as a consequence of changes to the income tax provisions effecting resource companies. Under the terms of the Company's flow-through share agreements, Emerald incurred \$1.4 million of qualifying oil and natural gas exploration and development expenses between January 1, 2004 and December 31, 2004. Emerald renounced the income tax benefits of these expenditures to the flow-through shareholders in 2003. The future tax impact of the renunciation of flow through shares has been reflected in equity.

LIQUIDITY AND CAPITAL RESOURCES

In order to support Emerald's growth oriented business plan, the Company's strategy is to fund its capital expenditure program by issuing common and flow-through shares, to reinvest its cash flow, and to utilize bank debt.

SHAREHOLDERS EQUITY

As at December 31, 2004, there were 11,708,304 common shares issued and outstanding, and an additional maximum total of 842,904 reserved for issuance on the potential exercise of common share purchase options. In addition, 1,108,000 common shares may be issued on the exercise of warrants associated with a December 2003 private placement.

CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The Company operates its office and shop under month to month lease arrangements and has no significant long term contractual obligations or contingencies.

OFF-BALANCE SHEET ARRANGEMENTS

Emerald did not enter into any off-balance sheet arrangements.

TRANSACTIONS WITH RELATED PARTIES

Emerald's initial significant shareholders have continued to support the Company's growth oriented business plan by investing additional funds by way of participating in Emerald's ongoing equity issues. As Emerald executes its growth plan, it is the Company's intention to continue to diversify its shareholder base by attracting new shareholders to participate in future offerings. Note 8 of the audited Financial Statements fully detail Emerald's related party transactions.

ACCOUNTING POLICIES

Emerald's accounting policies are stated in Note 3 to the audited Financial Statements. Emerald follows policies that are in accordance with Canadian generally accepted accounting principles.