

Emerald Bay Energy Inc.

Consolidated Financial Statements

March 31, 2015

(expressed in Canadian dollars)

(unaudited)

NOTICE OF NO AUDITOR REVIEW

In accordance with National Instrument 51-102 Section 4.3(3)(a) released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited Interim Consolidated Financial Statements for the three month period ended March 31, 2015 and 2014.

Emerald Bay Energy Inc.

Consolidated Statements of Financial Position

March 31, 2015 and December 31, 2014

(unaudited)

	March 31, 2015	December 31, 2014
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	45,307	169,556
Short-term investments	64,611	59,178
Trade and other receivables (note 15(b))	188,184	241,924
Prepaid expenses and deposits	28,132	36,029
Due from related parties (note 13(a))	50,000	50,000
Total current assets	376,234	556,687
Non-current assets		
Due from related parties (note 13(a))	197,970	197,970
Equity investment in PRI (note 4)	247,390	297,744
Exploration and evaluation assets and other intangible assets (note 6)	1,740,030	1,571,666
Property and equipment (note 5)	259,649	253,504
Total assets	2,821,273	2,877,571
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 15(c))	4,073,282	4,016,905
Shareholder indemnity (note 14(c))	333,551	333,551
Current portion of bank loan (note 9)	13,689	-
Loan (note 10)	1,300,000	1,300,000
Convertible debt (note 11)	456,705	290,025
Current portion of vehicle loan (note 14(b))	8,229	14,988
Total current liabilities	6,185,456	5,955,469
Non-current liabilities		
Bank loan (note 9)	19,573	37,002
Decommissioning obligations (note 8)	525,098	510,604
Total liabilities	6,730,127	6,503,075
Shareholders' deficit		
Share capital (note 12(b))	11,341,263	11,341,263
Warrants (note 12(c))	635,113	635,113
Contributed surplus (note 12(f))	1,824,074	1,824,074
Deficit	(17,679,987)	(17,420,929)
Accumulated other comprehensive loss	(29,317)	(5,025)
Total shareholders' deficit	(3,908,854)	(3,625,504)
Total liabilities and shareholders' deficit	2,821,273	2,877,571
Reporting entity and going concern (note 1)		
Commitments (note 14)		
Subsequent events (note 10 and 17)		

Approved on behalf of the Board of Directors

Signed "Shelby D. Beattie"

Director

Signed "Gibson C. Scott"

Director

Emerald Bay Energy Inc.

Consolidated Statements of Comprehensive Loss For the three months ended March 31, 2015 and 2014 (unaudited)

	March 31, 2015	March 31, 2014
	\$	\$
Revenue		
Petroleum and natural gas revenue	4,637	27,146
Royalties	(473)	(1,729)
	<u>4,164</u>	<u>25,417</u>
Operating expenses		
Production and operating expenses	9,356	29,827
Depletion and depreciation (note 5)	4,932	21,862
General and administrative	160,093	129,327
Foreign exchange loss (gain)	(5,139)	(981)
Share-based payment expense (note 12(d))	-	4,929
	<u>169,242</u>	<u>184,964</u>
Results from operating activities	<u>(165,078)</u>	<u>(159,547)</u>
Finance expense		
Interest income	-	1,616
Interest expense	(42,121)	(35,426)
Accretion of decommissioning obligation (note 8)	(1,505)	(4,420)
Net finance expense	<u>(43,626)</u>	<u>(38,230)</u>
Other income and expenses		
Equity (loss) income on investment in PRI (note 4)	(50,354)	42,782
Net other income and expenses	<u>(50,354)</u>	<u>42,782</u>
Net loss for the period	<u>(259,058)</u>	<u>(154,995)</u>
Other comprehensive (loss) income		
Foreign currency translation adjustment	(24,292)	(10,503)
Total comprehensive loss for the period	<u>(283,350)</u>	<u>(165,498)</u>
Basic and fully diluted loss per share (note 12(g))	(0.00)	(0.00)
Weighted average number of common shares outstanding during the period	158,610,189	140,671,689

Emerald Bay Energy Inc.

Statements of Changes in Deficit

For the three months ended March 31, 2015 and 2014

(unaudited)

	Share capital	Warrants	Contributed surplus	Deficit	Accumulated other comprehensive loss	Total deficit
	\$	\$	\$	\$	\$	\$
Balance, December 31, 2013	10,601,224	675,057	1,664,311	(15,929,544)	(1,481)	(2,990,433)
Share-based payment expense	-	-	4,929	-	-	4,929
Loss for the period	-	-	-	(154,995)	-	(154,995)
Foreign exchange translation to presentation currency	-	-	-	-	(10,503)	(10,503)
Balance, March 31, 2014	10,601,224	675,057	1,669,240	(16,084,539)	(11,984)	(3,151,002)
Balance, December 31, 2014	11,341,263	635,113	1,824,074	(17,420,929)	(5,025)	(3,625,504)
Loss for the period	-	-	-	(259,058)	-	(259,058)
Foreign exchange translation to presentation currency	-	-	-	-	(24,292)	(24,292)
Balance, March 31, 2015	11,341,263	635,113	1,824,074	(17,679,987)	(29,317)	(3,908,854)

Emerald Bay Energy Inc.

Consolidated Statements of Cash Flows

For the three months ended March 31, 2015 and 2014

(unaudited)

	March 31, 2015	March 31, 2014
	\$	\$
Cash (used in) provided by:		
Operating activities		
Net loss for the period	(259,058)	(154,995)
Adjustments for:		
Depletion and depreciation (note 5)	4,932	21,862
Accretion of decommissioning obligation (note 8)	1,505	4,420
Equity pick-up on investment in PRI (note 4)	50,354	(42,782)
Unrealized foreign exchange	(59,505)	(51,913)
Share-based payment expense (note 12(d))	-	4,929
	<u>(261,772)</u>	<u>(218,479)</u>
Change in accounts receivable	53,740	35,994
Change in prepaid expenses and deposits	7,897	(5,816)
Change in accounts payable and accrued liabilities	(80,189)	100,522
Change in due to related party	-	(1,617)
	<u>(280,324)</u>	<u>(89,396)</u>
Investing activities		
Property and equipment expenditures (note 5)	(6,878)	(2,476)
Exploration and evaluation expenditures (note 6)	(32,681)	(73,367)
Change in short-term investments	(5,433)	(2,137)
Change in accounts payable and accrued liabilities	136,565	108,234
	<u>91,573</u>	<u>30,254</u>
Financing activities		
Repayment of vehicle loan (note 14(b))	(6,758)	(6,392)
Receipt of loan (note 10 and note 11)	75,000	210,550
Repayment of bank loan (note 9)	(3,740)	-
	<u>64,502</u>	<u>204,158</u>
Change in cash and cash equivalents	(124,249)	145,016
Cash and cash equivalents, beginning of period	169,556	160,886
Cash and cash equivalents, end of period	45,307	305,902

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

1 Reporting entity and going concern

Emerald Bay Energy Inc. (the “Company”) was incorporated under the Business Corporations Act of Alberta on May 9, 1997 and is listed on the TSX Venture exchange. The Company is engaged in the exploration for and development of petroleum and natural gas properties principally in Alberta and Texas. The Company is listed on the TSX Venture exchange under the symbol “EBY.V”. The Company’s registered head office is located at #3A, 4015 – 1 Street South East, Calgary, Alberta, Canada T2G 4X7.

At March 31, 2015, the Company had not yet achieved profitable operations, had an accumulated deficit of \$17,679,987 since its inception (December 31, 2014 - \$17,420,929), had negative cash flows from operations of \$280,324 (December 31, 2014 - \$699,315) and had a working capital deficiency of \$5,809,222 (December 31, 2014 - \$5,398,782) (defined as current assets less current liabilities), and expects to incur further losses in the development of its business. The ability to continue as a going concern is dependent on obtaining continued financial support, completing public equity financing, or generating profitable operations in the future. Management is committed to raising additional capital to meet its exploration and operating obligation, however, additional equity financing is subject to the global financial markets and economic conditions, which have recently been disrupted and are volatile, and the debt and equity markets, which have been distressed, particularly for junior petroleum and natural gas companies. All of these factors, together with weak natural gas prices and the current unstable economic conditions, indicate the existence of material uncertainties related to events or conditions that may cast significant doubt as to whether the Company can continue as a going concern and, therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business. These consolidated financial statements do not reflect the adjustments to the carrying value of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications that would be necessary if the going concern assumption was not appropriate. Any adjustments necessary to the consolidated financial statements if the Company ceases to be a going concern could be material.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

2 Basis of presentation

a) Statement of compliance:

The interim condensed consolidated financial statement have been prepared in accordance with International Accounting Standards (“IAS”) 34 – “*Interim Financial Reporting*” as issued by the International Accounting Standards Board (“IASB”) using the accounting policies and methods of computation disclosed in the Company’s audited consolidated financial statements for the year ended December 31, 2014. These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2014 and exclude certain disclosures required to be included in annual consolidated financial statements.

The Board of Directors approved the interim consolidated financial statements on June 1, 2015.

b) Basis of measurement:

The interim consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments, which are measured at fair value, as explained in note 3 – Significant Accounting Policies included in the Company’s audited consolidated financial statements for the year ended December 31, 2014.

c) Basis of consolidation:

These interim consolidated financial statements include the accounts of the Company and its US branch and Emerald Bay Texas Inc., its wholly-owned and controlled subsidiary. Control exists when the Company has the power over the investee, exposure or rights to variable returns from its involvement and has the ability to affect those returns through its power over the investee. The financial statements of subsidiaries, including entities which the Company controls, are included in the interim consolidated financial statements from the date that control commences until the date that control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. All intercompany transactions and balances have been eliminated.

d) Nature and purpose of equity and reserves:

The reserves recorded in equity on the Company’s interim consolidated Statement of Financial Position include ‘Contributed Surplus’, ‘Accumulated Other Comprehensive Loss’, and ‘Accumulated Deficit’.

‘Contributed Surplus’ is used to recognize the value of stock options and broker warrants prior to exercise.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

'Accumulated Other Comprehensive Loss' is the foreign exchange gain or loss resulting from the translation of the Corporation's foreign subsidiary.

'Accumulated Deficit' is used to record the Corporation's change in deficit from profit or loss from year to year.

e) Use of estimates and judgments:

In preparing these interim condensed consolidated financial statements, management makes judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

The significant judgments made by management in applying the accounting policies and the key sources of estimation uncertainty were the same as those that applied to the audited annual consolidated financial statements as at and for the year ended December 31, 2014.

3 Recent accounting pronouncements

The Company has reviewed the new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Company. The Company has not quantified the effect of the following:

IFRS 15 – "Revenue from Contracts with Customers", replaces International Accounting Standard 11, "Construction Contracts" ("IAS 11"), IAS 18, "Revenue" ("IAS 18"), and several revenue-related interpretations. IFRS 15 establishes a single revenue recognition framework that applies to contracts with customers. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. Disclosure requirements have also been expanded. This IFRS becomes effective for annual periods beginning on or after January 1, 2017 with earlier adoption permitted. The standard may be applied retrospectively or using a modified retrospective approach. The Company is currently evaluating the impact of adopting IFRS 15 on the Consolidated Financial Statements.

IFRS 9 – "Financial Instruments", which is the result of the first phase of the IASB's project to replace IAS 39 – "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. This IFRS becomes effective for periods beginning on or after January 1, 2018. The Company has not yet begun the process of assessing the impact that the new standard will have on its financial statements.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements
For the three months ended March 31, 2015
(unaudited)

4 Equity investment in PRI

As at March 31, 2015, the Company maintains a 25% ownership in Production Resources Inc (“PRI”) based on the 25% ownership in the share capital of PRI. The Company has accounted for the investment using the equity method.

The investment in PRI as at March 31, 2015 is as follows:

	CDN \$
Net investment, December 31, 2013	\$332,678
Proportionate share of loss for the period	(34,934)
Net investment, December 31, 2014	\$297,744
Proportionate share of loss for the period	(50,354)
Net investment, March 31, 2015	<u>\$247,390</u>

Summarized financial information for PRI as at and for the three months ended March 31, 2015, is presented in the following table. The amounts have been translated from PRI’s reporting currency of USD to CAD at the March 31, 2015 exchange rate of \$1.2666 and the average rate for the three months ended March 31, 2015 of \$1.2412:

	USD\$	CAD\$
Current Assets		
Cash	54,288	68,761
Other current assets	308,286	390,475
	<u>362,574</u>	<u>459,236</u>
Property and equipment	3,498,155	4,430,763
Total assets	<u>3,860,729</u>	<u>4,889,999</u>
Current liabilities		
Trade and other accounts payable	460,092	582,753
Other current liabilities	68,627	86,923
	<u>528,719</u>	<u>669,676</u>
Long term debt	3,767,691	4,772,157
Total liabilities	<u>4,296,410</u>	<u>5,441,833</u>
	USD\$	CAD\$
Revenue	209,520	260,056
Operating expenses	(122,791)	(152,408)
Depletion and depreciation	(76,898)	(95,446)
Interest expense	(92,361)	(114,638)
General and admin	(79,744)	(98,978)
Net loss and comprehensive loss	<u>(162,274)</u>	<u>(201,414)</u>

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements
For the three months ended March 31, 2015
(unaudited)

5 Property and equipment

	Oil and natural gas interests \$	Power plant Interests \$	Corporate and Other \$	Total \$
Cost, December 31, 2014	4,385,626	120,389	323,175	4,829,190
Additions	-	6,878	-	6,878
Revisions in decommissioning liability	3,173	-	-	3,173
Foreign currency translation	-	-	1,735	1,735
Cost, March 31, 2015	4,388,799	127,267	324,910	4,840,976
Accumulated depletion, depreciation and impairment, beginning of period	(4,300,633)	-	(275,053)	(4,575,686)
Depreciation and depletion for the period	(114)	(1,510)	(3,308)	(4,932)
Foreign currency translation	-	-	(709)	(709)
Carrying value, March 31, 2015	88,052	125,757	45,840	259,649

	Oil and natural gas interests \$	Power plant interests \$	Corporate and Other \$	Total \$
Cost, December 31, 2013	4,306,882	-	317,297	4,624,179
Additions	72,088	120,389	4,644	197,121
Revisions in decommissioning liability	22,995	-	-	22,995
Disposal of oil and natural gas interests	(16,339)	-	-	(16,339)
Foreign currency translation	-	-	1,234	1,234
Cost, December 31, 2014	4,385,626	120,389	323,175	4,829,190
Accumulated depletion, depreciation and impairment, beginning of period	(3,904,320)	-	(257,649)	(4,161,969)
Depreciation and depletion for the period	(37,213)	-	(16,906)	(54,119)
Impairment of oil and natural gas interests	(359,100)	-	-	(359,100)
Foreign currency translation	-	-	(498)	(498)
Carrying value, December 31, 2014	84,993	120,389	48,122	253,504

During the year ended December 31, 2014, the Company entered into an agreement (the "Agreement") to develop, own and operate a natural gas fired electrical power generation plant (the "Power Plant"). Pursuant to the Agreement, the existing partners of certain wells agreed to contract all of their working interest shares of gas production from these wells as fuel for the Power Plant. Pursuant to the Agreement, the Company disposed of a portion of their working interest to the operator through a non-cash transaction in lieu of paying its portion of capital costs to develop the Power Plant. The deemed fair value of the acquired Power Plant interest was determined to be \$44,625. The carrying value of the working interest surrendered, was \$2,245 (including decommissioning liability of \$14,094). Accordingly, a gain on the disposition of \$42,380 was recorded in the statement of comprehensive loss. The Company is committed to contributing to the capital costs of the Power Plant if the costs of development are in excess

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements For the three months ended March 31, 2015 (unaudited)

of the budgeted amount. At March 31, 2015, the Company contributed \$82,642 (December 31, 2014 - \$75,764) to the development of the Power Plant.

6 Exploration and evaluation assets

	E&E assets
	\$
Balance, December 31, 2013	1,235,329
Additions	381,015
Revisions in decommissioning liability	4,300
Impairment (note 7)	(156,768)
Foreign currency translation	107,790
Balance, December 31, 2014	1,571,666
Additions	32,681
Revisions in decommissioning liability	-
Foreign currency translation	135,683
Balance, March 31, 2015	1,740,030

E&E assets consist of the Company's exploration projects which are pending the determination of technological feasibility and commercial viability. As at March 31, 2015, the Company incurred an amount of \$32,681 on E&E expenditures (December 31, 2014 - \$381,015). The additions represent the acquisition of undeveloped land and drilling activity within Texas. These E&E assets will be transferred to property and equipment when technological feasibility and commercial viability have been established. During the year ended December 31, 2014 indicators of impairment were identified and an impairment test was completed (note 7). Impairment of \$156,768 was recognized in the year.

7 Impairment loss

As at December 31, 2014, the Company reviewed its oil and gas assets for indicators of impairment such as changes in future prices, future costs and reserves. Based on this review, certain of the Company's CGUs were tested for impairment. The recoverable amount of each CGU was estimated based on the higher of the value in use and the FVLCTS. The estimate of FVLCTS was determined using a discount rate of 15% and forecasted cash flows, with escalating prices and future development costs, as obtained from the reserve report. The prices used to estimate the FVLCTS are those used by independent industry reserve engineers.

In light of a decline in natural gas prices, impairment tests were conducted at December 31, 2014 on the Company's oil and gas properties CGUs. The estimated recoverable amounts were determined using fair value less cost to sell.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

In determining the recoverability of gas interests and making these evaluations, the Company used the net present value of the cash flows from the proved plus probable reserves of oil and gas properties CGU as estimated by the Company's independent reserve evaluator.

Key input estimates used in the determination of cash flows from the oil and gas reserves include the following:

- a) Reserves – Assumptions that are valid at the time of reserve estimation may change significantly when new information becomes available. Changes in forward price estimates, production costs or recovery rates may change the economic status of reserves and may ultimately result in reserves being restated.
- b) Crude oil and natural gas prices – Forward price estimates of the crude oil and natural gas prices are used in the cash flow model. Commodity prices have fluctuated widely in recent years due to global and regional factors including supply and demand fundamentals, inventory levels, exchange rates, weather, economic and geopolitical factors.
- c) Discount rate – The discount rate used to calculate the net present value of cash flows is 15% post tax.

For the year ended December 31, 2014, the Company recorded an impairment of \$359,100 on its oil and gas properties CGU. The impairment was recognized because the carrying value exceeded the recoverable amount. The fair value less cost to sell values used to determine the recoverable amounts of the impaired PP&E assets are classified as Level 3 fair value measurements.

The E&E asset impairment is \$156,768 for the year ended December 31, 2014. The impairment was recognized upon a review of each exploration license or field, carried out, at least annually, to confirm whether the Company intends further appraisal activity or to otherwise extract value from the property.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements
For the three months ended March 31, 2015
(unaudited)

8 Decommissioning obligations

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites and gathering systems. The total decommissioning obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the decommissioning obligations to be \$525,098 as at March 31, 2015 (December 31, 2014 - \$510,604) based on an undiscounted total future liability of \$504,139 (December 31, 2014 - \$483,745). These payments are expected to be made over the next 2 to 24 years. The obligations have been calculated using an inflation rate of 2% and a discount factor, being the risk-free rate related to the liability, of 0.72% - 2.24% (December 31, 2014 - 2% and 1.01% - 2.33%, respectively).

	March 31, 2015	December 31, 2014
	\$	\$
Balance, beginning of period	510,604	559,751
Disposals	-	(14,094)
Abandonments	-	(92,767)
Revisions (changes in estimates)	3,173	40,032
Foreign currency translation	9,816	-
Accretion	1,505	17,682
Balance, end of period	525,098	510,604

During the year ended December 31, 2014, the Orphan Well Society abandoned and reclaimed certain wells owned by the Company. The costs incurred by the Orphan Well Society of \$92,767 to abandon and reclaim the wells were recorded as a gain in the Company's statement of loss and comprehensive loss for the year ended December 31, 2014.

9 Bank loan

On July 10, 2014, the Company and its joint venture partners ("Partners") on the Electric Generation Pilot Project ("Project") entered into a loan agreement (the "Loan") with a Canadian Chartered Bank (the "Lender") in the amount of \$500,000, of which the Company is liable for \$42,500. The proceeds of the Loan were used towards the purchase of equipment utilized in the Project. The Loan matures on June 14, 2017 and bears interest of 5.75% per annum, calculated daily, compounded and payable monthly. Principal repayments are required monthly until maturity. At March 31, 2015, the Company's portion of principal repayments and interest payments were \$3,740 and \$510, respectively (December 31, 2014 - \$5,498 and \$972 respectively), and the outstanding balance is \$33,262 (December 31, 2014 - \$37,002). The Loan is secured against certain assets as collateral of the Company and Partners.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

10 Loan

On June 15, 2012, a corporation owned by a party who has a common significant shareholding (the "Lender") advanced \$1,500,000 to the Company under a loan agreement (the "Original Loan Agreement") with a maturity date of August 15, 2013. Interest on the loan is 10% per annum, payable monthly, on the outstanding principal amount. On August 15, 2013, the Original Loan with an outstanding balance of \$1,200,000 was cancelled, and a new loan in the amount of \$1,200,000 was issued with a maturity date of August 15, 2014 (the "New Loan"), with all terms and conditions remaining the same.

Pursuant to the New Loan agreement, the Company issued to the Lender 5,000,000 share purchase warrants (the "New Warrants"). Each New Warrant was exercisable into one common share of the Company at a price of \$0.05 per common share until the expiry date of August 15, 2014. On April 9, 2014, the New Warrants received regulatory approval and accordingly were valued as of this date at \$40,241 and were treated as a transaction cost, and were netted against the principal balance of the loan, which was accreted back up to the principal balance at the maturity date. The accretion of the New Warrants was recorded as a non-cash finance expense in the consolidated statement of comprehensive loss. On August 15, 2014, the New Warrants expired unexercised.

On October 2, 2014, the Company received approval to extend the maturity date of the New Loan until August 15, 2015, with a 10% interest rate that compounds monthly (the "Extension"). Pursuant to the Extension, no warrants were offered, however a conversion feature enabling the Lender to convert any or all of the outstanding Extension into common shares of the Company at a conversion price of \$0.05 per common share at any time prior to the August 15, 2015, subject to regulatory approval. As at March 31, 2015, the conversion feature on the Extension had not yet receive regulatory approval and accordingly no value has been assigned to this feature. All other terms and conditions of the Extension remain unchanged. Subsequent to March 31, 2015, the conversion feature received regulatory approval and will be valued and reflected in the consolidated financial statements of the Company as of the date of regulatory approval.

The Company may, at any time, repay the Extension in full without notice or penalty. If the Company is in default of the requirements included in the Extension agreement or the Lender believes the Company's ability to repay the loan is impaired, the Lender may demand repayment of the Extension or accelerate the date for payment. During the three months ended March 31, 2015, the Company incurred interest of \$32,500 (March 31, 2014 - \$30,000).

During the year ended December 31, 2014, the Lender advanced an additional \$100,000 to the Company under the same terms as the New Loan. However, the additional advance was not included in the conversion feature.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

The following table summarizes the accounting of the Loan:

	Loan \$
Balance, December 31, 2013	<u>1,200,000</u>
Receipt of additional funds	100,000
Transaction costs	(93,710)
Accretion of transaction costs	93,710
Balance, December 31, 2014 and March 31, 2015	<u><u>1,300,000</u></u>

Security for the New Loan consists of a \$1,200,000 promissory note plus interest at the rate of 10% per annum, compounded monthly, a General Security Agreement in favour of the Lender to include a specific assignment of production proceeds, and security over the US assets of the Company. The Lender has required the Company to submit to them certain reports including monthly production reports.

11 Convertible debt

On January 1, 2012, the Company entered into a loan agreement (the "Loan Agreement") with a corporation owned and controlled by a party who is also a significant shareholder of the Company (the "Lender") whereby the Company received a \$150,000 USD loan with a maturity date of one year. Pursuant to the Loan Agreement, if it is mutually agreed upon by both parties, the maturity date can be extended by an additional year. On January 1, 2014 and March 26, 2015, it was mutually agreed upon between the Lender and the Company to extend the loan under the same terms for an additional year to December 31, 2014 and December 31, 2015, respectively. Interest on the loan is 12% per annum, payable monthly, on the outstanding principal amount monthly. During the three months ended March 31, 2015, the Company incurred interest of \$7,494 (March 31, 2015 - \$4,866).

Security for the loan consists of a \$150,000 promissory note and monthly production from certain Texas assets equivalent to the principal portion of the loan and any unpaid interest.

At the option of the Lender, and subject to regulatory approval, the entire principal amount, or any portion outstanding, may be converted to shares in the Company with a discount of 25% to the market trading price at the time of conversion, at any time during the term. Accordingly, on the issuance and extension, the loan is split between the liability and the conversion feature, which is recorded on the statement of financial position as a derivative financial liability. The liability portion is determined by subtracting the fair value of the conversion feature from the principal amount of the loan. The fair value of the conversion feature is estimated at every statement of financial position date with changes in the fair value estimate between periods recognized in the consolidated statement of comprehensive loss as finance expense. The liability portion is

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

measured at amortized cost and is accreted up to the principal balance at the maturity date. The accretion is expensed as a finance expense in the consolidated statement of comprehensive loss as finance expense. Any accrued interest thereon may also be converted in to common shares, in accordance with the regulatory policies.

On the January 1, 2014 extension, the terms of the conversion feature were changed to establish the conversion price to be \$0.05 per common share, and accordingly, \$72,572 of the principal amount of the loan was classified as a derivative financial liability. All other terms and conditions remain the same. At December 31, 2014, the loan had matured and the derivative liability that was recognized was removed and recorded as a gain on the derecognition of the derivative financial liability in the consolidated statement of comprehensive loss as finance expense. As at March 31, 2015, the conversion feature on the March 26, 2015 extension had not yet received regulatory approval and accordingly no value has been assigned to this feature. All other terms and conditions of the extension remain unchanged.

On March 26, 2015, the Lender advanced an additional loan amount of \$75,000 CDN (December 31, 2014 – additional amount of \$100,000 USD) to the Company under the same terms as the Loan Agreement. However, the additional advances were not included in the conversion feature. The modifications did not result in an extinguishment of the old convertible debt instrument and recognition of a new convertible debt instrument. The proceeds of the loan were used to continue the Company's exploration program in Texas.

The following table summarizes the accounting of the promissory note in USD:

	Liability \$	Derivative Financial Liability \$	Total \$
Balance, December 31, 2013	150,000	-	150,000
Receipt of additional funds	100,000	-	100,000
Derivative financial liability	(72,572)	72,572	-
Accretion of debt	72,572	-	72,572
(Gain) on derivative financial liability	-	(72,572)	(72,572)
Balance, December 31, 2014	250,000	-	250,000
Receipt of additional funds	59,214	-	59,214
Balance, March 31, 2015	309,214	-	309,214

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements
For the three months ended March 31, 2015
(unaudited)

12 Share capital

a) Authorized

Unlimited number of common shares with voting rights
Unlimited number of preferred shares, issuable in series

b) Issued

	Number of Common Shares	Amount \$
Balance, December 31, 2013	140,671,689	10,601,224
Expiry of warrants (note 12(c))	-	809,550
Issue costs for expired warrants	-	(134,493)
Private placement (i)	16,938,500	896,925
Share subscription receivable	-	(50,000)
Value of warrants issued pursuant to private placement (i)	-	(759,435)
Share issue costs (i)	-	(22,508)
Balance, December 31, 2014 and March 31, 2015	<u>157,610,189</u>	<u>11,341,263</u>

- (i) On September 3, 2014, the Company completed a private placement ("Placement A"), issuing 17,938,500 units. Each unit under Placement A was issued at \$0.05 for total proceeds of \$896,925. Each unit consists of one common share of the Company and one share purchase warrant ("Warrant A"). Each Warrant A entitles the holder to purchase one additional common share of the Company at \$0.05 per share, exercisable for 1 year from the original issue date. The Company has allocated \$759,436 of the unit value to warrants (note 12(c)). Of the total units under issue by the Company, proceeds for 1,000,000 units were not received by the Company and have therefore been excluded.

Pursuant to Placement A, the Company incurred \$88,175 in cash share issue costs, of which \$13,517 was allocated to share capital and \$74,657 was allocated to warrants. 1,385,500 finders options were issued, respectively, valued at \$58,656 (note 12(e)), of which \$8,991 was allocated to share capital and \$49,665 was allocated to warrants.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements
For the three months ended March 31, 2015
(unaudited)

c) Warrants

Warrants to acquire common shares outstanding at March 31, 2015 are as follows:

	Number of warrants issued and exercisable	Amount \$	Weighted average exercise price \$	Weighted average Remaining life (years)
Balance, December 31, 2013	37,630,000	675,057	0.10	0.06
Expiry of share purchase warrants	(37,630,000)	(809,550)	-	-
Share purchase warrants issued (note 12(b)(i))	17,938,500	759,435	0.05	0.63
Share issue costs (note 12(b)(i))	-	(124,322)	-	-
Issue costs for expired warrants	-	134,493	-	-
Share purchase warrants issued pursuant to the Loan(note 10)	5,000,000	40,241	0.05	-
Expiry of share purchase warrants issued pursuant to the Loan(note 10)	(5,000,000)	(40,241)	-	-
Balance, December 31, 2014 and March 31, 2015	17,938,500	635,113	0.05	0.38

The fair value of the share purchase warrants granted during the year are estimated at the grant date using the Black-Scholes option pricing model and have been credited to warrants within shareholders' equity. A weighted average of the assumptions used in the calculation is noted below:

	2014
Risk-free rate	1.09%
Expected life	1 year
Expected volatility	281.90%
Fair value per warrant	\$0.040572

Volatility was determined based on the Company's historical share prices.

d) Stock options

The Company established a share option plan (the "Plan") for the benefit of officers, directors, employees and consultants of the Company. Under the Plan, the number of common shares to be reserved and authorized for issuance pursuant to options granted under the Plan cannot exceed 10% of the total number of issued and outstanding shares of the Company. The term, the vesting period and the exercise price are determined at the discretion of the Board of Directors. However, the maximum option term shall not exceed five years.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

During the three months ended March 31, 2015, there were no stock options granted, cancelled, exercised or stock options that expired unexercised. The following table summarizes information about the Company's stock options outstanding at March 31, 2015:

	March 31, 2015		December 31, 2014	
	Number of options	Weighted Average Exercise price \$	Number of options	Weighted Average Exercise price \$
Stock options outstanding, end of period	14,030,000	0.08	14,030,000	0.08

The total stock options outstanding at March 31, 2015 are as follows:

Exercise prices (\$)	Options outstanding	Weighted average remaining term (years)	Weighted average exercise price (\$)
0.05	6,700,000	3.55	0.05
0.10	7,330,000	0.95	0.10

As at March 31, 2015, all stock options have vested and are exercisable.

During the three months ended March 31, 2015, the Company recognized share-based payment expense of \$nil in the statement of comprehensive loss (March 31, 2014 - \$4,929).

e) Finders options

During the year ended December 31, 2014, the Company issued 1,385,500 Finders Options ("Finders Options A), respectively, to the those who facilitated Placement A (note 12(b)(i)). Each Finders Options A is exercisable into one unit consisting of one common share and one common share purchase warrant ("Finder Warrant A") of the Company at \$0.05 per unit. Each Finder Warrant A is exercisable into one common share of the Company at \$0.05 per common share. The Finders Options A expire one year from the original grant date. The Finders Options A were valued at \$58,656 (note 12(b)(i)). The warrant embedded within the Finders Options A were not separately valued.

The following table summarizes information about the Company's Finder Options outstanding at March 31, 2015:

	March 31, 2015		December 31, 2014	
	Number of options	Weighted Average Exercise price \$	Number of options	Weighted Average Exercise price \$
Finders Options outstanding, end of period	1,385,500	0.05	1,385,500	0.05

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements
For the three months ended March 31, 2015
(unaudited)

The fair value of the Finders Options granted were estimated as at the grant date using the Black-Scholes option pricing model. The assumptions used in the calculation are noted below:

	<u>2014</u>
Risk-free interest rate	1.01%
Expected life	1 year
Expected volatility	282.05%
Fair value per option	\$0.04

Volatility was determined based on the Company's historical share prices.

f) Contributed surplus

	March 31, 2015	December 31, 2014
	\$	\$
Balance, beginning of period	1,824,074	1,664,311
Share-based payment expense	-	7,397
Finders options (note 12(b))	-	58,656
Expiry of share purchase warrants (note 10)	-	93,710
Balance, end of period	1,824,074	1,824,074

g) Per share data

Basic earnings per share are calculated based on the weighted average number of shares outstanding during the period. The treasury stock method is used for the calculation of diluted loss per share. Under this method, it is assumed that proceeds from the exercise of dilutive securities are used by the Company to repurchase Company shares at the average price during the period.

All warrants, finders options and stock options have been excluded from the calculation of diluted shares outstanding as they would be anti-dilutive due to the loss position of the Company.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements
For the three months ended March 31, 2015
(unaudited)

13 Related party transactions

Related party transactions not disclosed elsewhere in these Consolidated Financial Statements are as follows:

a) The following amounts are due from related parties:

	March 31, 2015	December 31, 2014
	\$	\$
Note receivable from officer	247,970	247,970
Less current portion	(50,000)	(50,000)
	<u>197,970</u>	<u>197,970</u>

During the year ended December 31, 1999, a promissory note was issued to an officer of the Company bearing interest at 3% per annum with no fixed maturity date, unless the officer's employment is terminated or he is petitioned into bankruptcy wherein the note and accrued interest becomes immediately payable. During the year ended December 31, 2014, the Company revised the terms of the loan (the "Revised Promissory Note"), including fixed repayment terms and removing the term securing the note with 393,000 common shares of the Company. Historically the aggregate decline in the fair value of these common shares since the inception of the promissory note would offset the amount payable. Under the Revised Promissory Note, a balance of \$247,970, including the principal of \$218,500 and accrued interest, is payable by the officer to the Company. The payments will commence December 31, 2015, and will be paid annually in \$50,000 tranches until December 31, 2018, with the final payment of \$47,970 due on December 31, 2019. Interest is calculated at 1% per annum, and is payable annually commencing December 31, 2015, concurrently with each principal payment. The officer may repay the principal amount in whole or in part at any time. The reversal of the fair value allowance of \$237,511 was included in the statement of loss and comprehensive loss.

b) Additional related party transactions not disclosed elsewhere in these Consolidated Financial Statements are as follows:

- (i) Aggregate fees of \$8,616 (March 31, 2014 - \$8,616) were charged by corporations, which are owned and controlled by other equity investors in PRI, and were all recorded as general and administrative costs.
- (ii) Included in accounts payable at March 31, 2015 was \$118,517 owing to officers of the Company (December 31, 2014 - \$104,611).

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

14 Commitments

- a) On March 5, 2014, the Company entered into a lease agreement with a related party for the lease of office space. Under a lease agreement, the Company has committed to monthly payments of \$2,771 for the lease of its office space until November 30, 2016.
- b) The Company has entered into various vehicle loan agreements and as at March 31, 2015, total principal repayments of \$8,229 remain, all of which will be paid in the year ending December 31, 2015.
- c) The Company raised capital through the issuance of flow through shares in 2009, 2010 and 2011 which provided indemnity to the subscriber for additional taxes payable if the Company was unable to, or failed to, renounce the qualifying expenditures as agreed. The Company was not able to spend \$824,338 of the flow through funds raised. The Company is exposed to costs for the indemnification of the subscribers. The Company has estimated a potential liability on the amount of \$333,551 at March 31, 2015 (December 31, 2014 - \$333,551). The Company has also estimated a potential liability for penalties and taxes on the amounts of \$107,500 (December 31, 2014 - \$107,500) and is included in accounts payable and accrued liabilities. The accrued amount is subject to measurement uncertainty due to the tax filing positions of the subscribers, their tax rates and the amount of personal taxes that may be payable and the interpretation of the indemnity agreement, which will not be known until potentially affected subscribers are reassessed for their tax positions by the Canada Revenue Agency and these amounts become known to the Company.

15 Financial risk management

The Board of Directors oversees managements' establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

(a) Fair values

The Company's financial instruments consist of cash and cash equivalents, short-term investments, trade and other receivables, due from related parties, accounts payable and accrued liabilities, the shareholder indemnity, the loan, the convertible debt, the bank loan, current portion of long-term debt and long-term debt.

Financial Instrument	Classification	Carrying Value	Fair Value
		\$	\$
Cash and cash equivalents	Fair value through profit and loss	45,307	45,307
Short-term investments	Fair value through profit and loss	64,611	64,611
Trade and other receivables	Loans and receivables	188,184	188,184
Due from related parties	Loans and receivables	247,970	247,970
Accounts payable and accrued liabilities	Other financial liabilities	4,073,282	4,073,282
Shareholder indemnity	Other financial liabilities	333,551	333,551
Loan	Other financial liabilities	1,300,000	1,300,000
Convertible debt	Other financial liabilities	456,705	456,705
Bank loan	Other financial liabilities	33,262	33,262
Current portion of long-term debt	Other financial liabilities	8,229	8,229

The significance of inputs used in making fair value measurements are examined and classified according to a fair value hierarchy. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

At March 31, 2015, the Company's cash and cash equivalents and short-term investments have been subject to Level 1 valuation.

(b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and oil and natural gas marketers.

Virtually all of the Company's trade and other receivables are from companies in the oil and gas industry and are subject to normal industry credit risks. Credit risks arise principally from the amounts owing to the Company from oil and natural gas marketers and joint venture partners. Management does not believe that any significant concentration of trade and other receivables exists that will result in any loss to the Company based on past payment experience. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

is to establish relationships with large marketers. However, the receivables are from participants in the petroleum and natural gas sector and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations and escalating costs. The Company does not typically obtain collateral from petroleum and natural gas marketers or others in the event of non-payment.

At March 31, 2015, the Company's trade and other receivables have been aged as follows:

	March 31, 2015	March 31, 2014
Days outstanding	\$	\$
0-30 days	4,627	16,880
31-60 days	730	1,276
61-90 days	1,358	929
Greater than 90 days	181,469	406,008
Total	188,184	425,093

Amounts outstanding for more than 90 days are considered past due. During the year ended December 31, 2014, the Company wrote off \$43,064 of trade and other receivables. The Company deems all amounts remaining in trade and other receivables as collectible and as such, a provision for doubtful accounts has not been recorded at March 31, 2015 (March 31, 2014 - \$nil).

Cash and cash equivalents consist of cash bank balances held in both interest and non-interest bearing accounts. The Company manages credit exposure of cash by selecting financial institutions with high credit ratings.

(c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. At March 31, 2015, the Company's maximum exposure to liquidity risk is the total current liabilities of \$6,185,456 (December 31, 2014 - \$5,955,469).

The current liabilities and commitments are due as follows:

Accounts payable and accrued liabilities	4,073,282	Due within 90 days
Loan (note 10)	1,300,000	Maturity date of August 15, 2015
Convertible debt (note 11)	456,705	Maturity date of December 31, 2015
Current portion of bank loan (note 9)	13,689	Due within 12 months
Current portion of long-term debt (note 14(b))	8,229	Due within 12 months
Shareholder indemnities (note 14(c))	333,551	Due on demand

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

The Company has entered into lease agreements on office premises for its various locations. Future minimum annual lease payments under the lease agreement are as follows:

2016	\$33,247
------	----------

The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

To achieve this objective, the Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. The Company also attempts to match its payment cycle with collection of oil and natural gas revenue on the 25th of each month.

(d) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's loss or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while maximizing returns.

(i) Commodity price risk:

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar but also world economic events that dictate the levels of supply and demand. All of the Company's oil and gas production is sold at spot rates exposing the Company to the risk of price movements.

The Company had no commodity call options outstanding as at March 31, 2015.

(ii) Currency risk:

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada and the United States and a portion of its expenses are incurred in US dollars. The Company does not hedge its exposure to fluctuations in the exchange rate. Future changes in exchange rates could have a material effect on the Company's business including its intended capital plans, its financial condition and results of operations.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements

For the three months ended March 31, 2015

(unaudited)

Certain of the Company's financial instruments are exposed to fluctuations in the US dollar, including cash and cash equivalents, trade and other receivables and accounts payable and accrued liabilities. As at March 31, 2015, an increase or decrease of 10% to the foreign exchange rate between the US dollar and the Canadian dollar applied to the average level of US denominated cash and cash equivalents would have had approximately a \$2,500 impact on the Company's comprehensive loss for the period.

(iii) Interest rate risk:

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. As at March 31, 2015, all of the Company's debt, including the the loan, the convertible debt and the bank loan, bears fixed interest rates and accordingly, is not subject to market interest rate fluctuations.

The Company has no interest rate swaps or financial contracts in place as at or during the period ended March 31, 2015.

(e) Capital management

The Company's capital consists of shareholders' deficit, the loan, the convertible debt and working capital. The Company will adjust its capital structure to manage its current and future debt, drilling programs and potential corporate acquisitions through the issuance of shares, sourcing additional debt financing and adjustments to capital spending. The Company's objective for managing capital is to maximize long-term shareholder value by ensuring adequate capital to achieve the Company's objectives. The Company is not subject to any external capital requirements.

Management reviews its capital management approach on an ongoing basis and believes its current approach is reasonable given the size of the Company. There has been no change in management's approach to capital management during the period.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements
For the three months ended March 31, 2015
(unaudited)

16 Segmented information

The Company's primary operations are limited to a single industry being the acquisition, exploration for, and development of petroleum and natural gas.

Product segmentation is as follows:

	Oil	Natural Gas	NGL's	Electricity	Total
March 31, 2015 (\$)	1,221	-	19	3,397	4,637
March 31, 2014 (\$)	3,066	24,048	32	-	27,146

Geographical segmentation is as follows:

	Three months ended March 31, 2015 (\$)		
	Canada	United States	Total
Petroleum and natural gas and electricity sales	4,637	-	4,637
Equity loss on investment in PRI	25,177	25,177	50,354
Depletion, depreciation and impairment	4,165	767	4,932
Net loss	236,235	22,823	259,058
Property and equipment	247,961	11,688	259,649
Exploration and evaluation assets	-	1,740,030	1,740,030
Share of investment in PRI	123,695	123,695	247,390
Total liabilities	4,592,651	2,137,476	6,730,127

	Three months ended March 31, 2014 (\$)		
	Canada	United States	Total
Petroleum and natural gas sales	28,782	(1,636)	27,146
Equity income on investment in PRI	21,391	21,391	42,782
Depletion, depreciation and impairment	21,257	605	21,862
Net loss (income)	177,646	(22,651)	154,995
Property and equipment	475,184	9,410	484,594
Exploration and evaluation assets	-	1,358,489	1,358,489
Share of investment in PRI	187,730	187,730	375,460
Total liabilities	4,378,816	1,847,410	6,226,226

17 Subsequent events

Subsequent to March 31, 2015, the Company was advanced an additional loan amount of \$75,000 under the same terms as the Loan Agreement described in Note 10. However, the additional advance was not included in the conversion feature.