



# *Emerald Bay Energy*

**EMERALD BAY ENERGY, INC.**

**MANAGEMENT DISCUSSION AND ANALYSIS**

**FOR THE QUARTER ENDED  
MARCH 31, 2009**

**MAY 28, 2009**

## MANAGEMENTS' DISCUSSION AND ANALYSIS

Management's Discussion and Analysis ("MD&A") is management's assessment of the financial position and operating results of Emerald Bay Energy Inc. for the three months ended March 31, 2009 and should be read in conjunction with the audited financial statements for the year ended December 31, 2008 and related notes. Readers should be aware that historical results are not necessarily indicative of future performance. Additional information relating to the Corporation is available on SEDAR at [www.sedar.com](http://www.sedar.com) and the Corporation's website [www.ebyinc.com](http://www.ebyinc.com).

At the time of writing this MD&A, substantially all revenues have been collected for the production period of March 2009. Management performs analysis on the amounts collected to ensure that the amounts accrued are accurate. Analysis is also performed regularly on royalties and operating costs to ensure that amounts have been accurately accrued.

Production information is commonly reported in units of barrel of oil equivalent ("boe"). 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.

The following discussion and analysis of financial information and related data concerning Emerald Bay Energy, Inc. is as of May 28, 2009 and is reported in Canadian dollars and 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 quarter ended March 31, 2009.

Non-GAAP Measures – The terms "cash flow from operations" and "cash outflow," which are expressed before changes in non-cash working capital, are used by the Corporation to analyze operating performance, leverage and liquidity. The term "field netback" is also used by the Corporation to analyze performance. Field netback is calculated by deducting from revenue the amount related to royalties, operating costs and transportation. These terms do not have any standardized meaning prescribed by GAAP and therefore might not be comparable with the calculation of a similar measure for other companies. The reconciliation between net earnings and cash flow from operations can be found in the consolidated statements of cash flows in the consolidated financial statements. The Corporation also presents cash flow from operations per share whereby per share amounts are calculated using weighted average shares consistent with the calculation of earnings per share.

### **Forward-looking Information and Statements**

Information which is contained herein contains estimates and assumptions which Emerald Bay is required to make concerning future events, and may constitute forward-looking statements under applicable securities laws. The forward-looking information and 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.

The forward-looking information and statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. Such information and statements involve known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those anticipated in such forward-looking information and statements including, without limitation: changes in commodity prices; changes in the demand for or supply of Emerald Bay's products; unanticipated operating results or production declines; changes in tax or environmental laws, royalty rates or other regulatory matter; changes in development plans of Emerald Bay or by third party operators of certain Emerald Bay properties, increased debt levels or debt service requirements; limited, unfavorable or a lack of access to capital markets; increased costs; and certain other risks detailed from time to time in Emerald Bay's public disclosure documents. The forward-looking information and statements contained in this MD&A speak only as of the date of this MD&A. Emerald Bay assumes no obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable laws.

This management discussion and analysis was dated on May 28, 2009.

## 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.

### For the three months ended

	Mar 31 2009 (\$)	Mar 31 2008 (\$)
Revenues (before royalties)	384,376	664,830
Cash flow from operations	149,342	116,328
Total assets	7,054,703	6,233,568
Secured debt	2,825,000	2,511,251

## DETAILED REVIEW OF FINANCIAL RESULTS

### *Net Loss and Cash Flow*

### For the three months ended

	Mar 31 2009 (\$)	Mar 31 2008 (\$)
Net profit(loss)	101,749	(18,803)
Per share	0.01	(0.00)
Cash flow from operations	149,342	116,328
Per share	0.01	0.01

The Company has recorded a net profit of \$101,749 for the three months ended March 31, 2009, compared to a net loss of \$18,803 for the three months ended March 31, 2008.

### *Revenue*

### For the three months ended

	Mar 31 2009 (\$)	Mar 31 2008 (\$)
Oil and NGLs	85,712	173,460
Per barrel	35.39	92.78
Natural gas	298,664	491,371
Per mcf	5.68	8.34
Total gross revenue	384,376	664,830
Per boe	34.35	56.87

Gross revenue from natural gas production and oil production decreased as compared to 2008 due to significantly lower commodity prices.

### **Sales Volumes**

#### **For the three months ended**

	<b>Mar 31 2009</b>	<b>Mar 31 2008</b>
Crude oil – barrels per day	<b>12</b>	9
Natural gas – mcf per day	<b>585</b>	640
NGLs – barrels per day	<b>15</b>	11
BOE – barrels per day	<b>124</b>	120

Sales volumes were higher in 2009 at 124 barrels per day as compared to 120 barrels per day in first quarter 2008 as new wells were brought on line. In addition there were weather related issues in January and February causing several wells to be shut down for extended periods.

### **Operating costs**

#### **For the three months ended**

	<b>Mar 31 2009 (\$)</b>	<b>Mar 31 2008 (\$)</b>
Operating expenses	<b>115,674</b>	132,120

Operating expenses decreased in 2009 compared to 2008 despite an increase in production and the addition of new wells as the Company focused on variable operating costs.

### **General and administrative expenses**

#### **For the three months ended**

	<b>Mar 31 2009 (\$)</b>	<b>Mar 31 2008 (\$)</b>
General and administrative expense	<b>397,581</b>	263,472

General and administrative expenses increased due to a higher level of activity in consulting fees in 2009 compared to 2008 relating to the addition of new wells. The Company does not capitalize any administrative costs.

### **Depletion, depreciation and site restoration expense**

#### **For the three months ended**

	<b>Mar 31 2009 (\$)</b>	<b>Mar 31 2008 (\$)</b>
Depletion, depreciation and amortization	<b>45,625</b>	126,284
Asset Retirement Obligation - Accretion	<b>1,968</b>	2,150
Total	<b>47,593</b>	128,434

Depletion, depreciation and amortization decreased in 2009 as compared to 2008 as higher capital costs were more than offset by increases in reserves related to new wells.

## 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 March 31, 2009, there were 37,034,446 common shares issued and outstanding, and an additional maximum total of 3,703,445 reserved for issuance on the potential exercise of common share purchase options.

## CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

At year end the Company operated its office under lease arrangement for Three (3) years commencing October 1, 2006 and ending September 30, 2009 with a 90 day termination clause.

Subsequent to the year end the Company terminated its lease and entered into a new lease arrangement for Five (5) years commencing April 1, 2009 and ending March 31, 2014.

As at December 31, 2008, the Company has a remaining commitment to spend of approximately \$500,000 on the total flow through funds raised in 2008 of \$1,219,375 and renounced in full to the shareholders by year end.

## OFF-BALANCE SHEET ARRANGEMENTS

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

## DUE FROM RELATED PARTIES AND RELATED PARTY TRANSACTIONS

- a) The following amounts are due by related parties:

	<u>Mar 31, 2009</u>	<u>Dec 31, 2008</u>
<b>Due from related party</b>		
<b>Note receivable from officer (i)</b>	<b>\$ 218,500</b>	<b>\$ 218,500</b>
<b>Fair value allowance</b>	<b>(206,710)</b>	<b>(206,710)</b>
	<b><u>\$ 11,790</u></b>	<b><u>\$ 11,790</u></b>

- (i) Note receivable from officer  
Promissory note bearing interest at 3% per annum and repayable by December 31, 2009. The note is secured by 393,000 common shares of the Company.
- (ii) For financial statement purposes the Corporation has provided an allowance to the estimated fair value of the underlying security \$35,370 (2008 - \$35,370)
- b) Except as disclosed elsewhere in the financial statements, the Company was involved in the following related party transactions for the quarter ended March 31, 2009.

- (i) Directors and officers, have charged the Company for the three months ended March 31, 2009 \$103,410 (2008 - \$76,403) for services.
- (ii) A law firm in which a director is a partner has charged the Company for the three months ended March 31, 2009 \$5,814 (2008 - \$630) in legal fees.
- (iii) An oil and gas completions, operations, geological and consulting firm owned 100% by a director has charged the Company for the three months ended March 31, 2009 \$0 (2008 - \$18,900) in consulting fees.
- (iv) A director was advanced fees totaling \$0 (2008 – \$20,961) in relation to efforts to finance and advance the Company's drilling technology. There is no guarantee that such effort will be successful. If such efforts are not successful, the full balance will be repaid in 2009. The above amount is included in accounts and cash call receivable at year end.
- (v) A U.S. corporation, providing field operation services in relation to operating the company's U.S. properties, owned and controlled by an officer and a director has charged the Company \$0 (2008 - \$41,544).

Transactions in the normal course of operations are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

### **ACCOUNTING POLICIES**

Emerald's accounting policies are stated in Note 2 to the audited Financial Statements for the years ended December 31, 2008 and December 31, 2007. Emerald follows policies that are in accordance with Canadian generally accepted accounting principles.

### **LEGAL MATTERS**

In 2005, an oilfield service provider commenced legal action against the Company relating to the loss of a tool in the well bore of one of the Company's wells claiming total damages of \$193,121. As a result of this incident the Company counterclaimed for \$760,000 plus additional damages. Subsequent to the year end the action was settled by the Company's insurance provider.

In 2008, an oilfield service provider commenced legal action against the Company relating to disputed cost overruns during drilling operations totalling \$110,675. As a result of the incident the Company has counterclaimed for \$246,437 plus additional damages. In the opinion of management, the outcome of this action is not determinable at this time and as the Company only an 18% interest in the action it will have no material outflow or recovery.

### **BUSINESS RISKS**

The oil and gas industry is subject to risks in (among others):

- finding and developing reserves,
- commodity prices received for such reserves,
- availability of equipment, manpower and supplies,
- availability and cost of capital to achieve projected growth,
- effect of weather on drilling and production, and
- operating in an environmentally appropriate fashion.

Emerald Bay mitigates these business risks by:

- Having assets in several diverse fields.
- Maintaining cost-effective operations.
- Operating our own properties were possible to control the amount and timing of capital expenditures.
- Using new technology to maximize production and recoveries and reduce operating costs.
- Drilling wells in areas with multiple zone potential.

## **POLITICAL, REGULATORY AND ENVIRONMENTAL RISKS**

Separate from the business risks above are political, regulatory and environmental risks. Emerald Bay mitigates environmental risk directly related to its own operation through its insurance program and by diligent care and attention in the field. However, Emerald Bay is unable to mitigate political, regulatory and environmental risks that stem from sources outside its own operations.

## **Financial Instruments – Disclosures and Presentation**

Effective January 1, 2008, the Corporation adopted two new Canadian Institute of Chartered Accountants (“CICA”) standards. Handbook Section 3862, Financial Instruments – Disclosures and Handbook Section 3863, Financial Instruments – Presentation. These Handbook Sections replaced existing Handbook Section 3861, Financial Instruments – Presentation and Disclosure. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. Specifically, section 3862 requires disclosure of the significance of financial instruments on the Corporation’s financial position. In addition, the guidance outlines revised requirements for the disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments. The new presentation standard carries forward the former presentation requirements.

## **Comprehensive Income**

The Corporation does not have any items to be accounted as components of other comprehensive income (“OCI”) and as a result comprehensive income equals net (loss) earnings.

## **Capital Disclosures**

Effective January 1, 2008, the Corporation adopted Handbook Section 1535, Capital Disclosures which requires companies to disclose their objectives, policies and processes for managing capital, the nature of externally imposed capital requirements, how the requirements are incorporated into the Corporation’s management of capital, whether the requirements have been complied with, or consequence of noncompliance and an explanation of how the Corporation is meeting its objectives for managing capital. In addition, quantitative disclosures regarding capital are required.

In addition, the Corporation has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have a significant impact on the Corporation.

## **International Financial Reporting Standards**

In January 2006, the CICA Accounting Standards Board adopted a strategic plan for the direction of accounting standards in Canada. As part of the plan, accounting standards in Canada for public companies will converge with International Financial Reporting Standards ("IFRS") on January 1, 2011. The Corporation continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS.

## **FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

The Corporation has the following financial instruments:

Accounts receivable and deposits are designated as loans and receivables and are measured at amortized cost. Accounts payable and accrued liabilities and bank debt are designated as other financial liabilities and are measured at amortized cost.

### ***a) Market risk***

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Corporation's net earnings or the value of financial instruments. These risks are generally outside the control of the Corporation.

### ***b) Credit risk***

The majority of the Corporation's accounts receivable are due from joint venture partners in the oil and gas industry and from purchasers of the Corporation's petroleum and natural gas production and are subject to the same industry factors such as commodity price fluctuations and escalating costs. The Corporation generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes risk is mitigated by the size and reputation of the companies to which they extend credit. The Corporation has not experienced any credit loss in the collection of accounts receivable in 2008.

Receivables from petroleum and natural gas marketers are normally collected on the twenty-fifth day of the month following production. Receivables related to the sale of the Corporation's oil and natural gas production are from major marketing companies. The Corporation historically has not experienced any collection issues with its petroleum and natural gas marketers.

Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Corporation attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure and issuing cash calls on large capital projects from its partners on capital projects before they commence.

\$162,393 due from SemCanada Crude Company. SemCanada Crude Company entered into CCAA proceedings on July 21, 2008. The results of the CCAA proceedings are undeterminable at this time. The company has taken a 100% provision against this receivable.

### **(c) Liquidity risk**

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. The Corporation's approach to managing liquidity is to ensure that it will have sufficient liquidity to meet its liabilities when due. The nature of the oil and gas industry is very capital intensive. As a result, the Corporation prepares annual capital expenditure budgets and utilizes authorizations for expenditures for projects to manage capital expenditures. Refer to note 7 for disclosure related to the management of capital.

### **(d) Fair value of financial instruments**

The Corporation's accounts receivable, deposits, bank debt and accounts payable and accrued liabilities approximates their carrying value due to their short terms to maturity and the floating interest rate on the Corporation's debt.

## **CAPITAL MANAGEMENT**

The Corporation's capital consists of shareholders' equity, bank debt and working capital. The Corporation will adjust its capital structure to manage its current and future debt, drilling programs and potential corporate acquisitions through the issuance of shares, increasing the credit facility line and adjustments to capital spending.

The Corporation's objective for managing capital is to maximize long-term Shareholder value by ensuring adequate capital to achieve the Corporation's objectives.

The Corporation monitors capital structure using non-GAAP measures, based on the ratio of net debt to annualized funds flow. The Corporation also monitors capital structure by reviewing net asset value.

The Corporation is bound by certain debt covenants. These covenants include maintaining a Working Capital Ratio of not less than 1.0 to 1.0 at all times. The Working Capital ratio for this purpose is defined as Current Assets (including the un-drawn Availability under the Credit Facility A) to Current Liabilities (excluding any current portion of Bank Debt). As at March 31, 2008, the Corporation was not in violation of any bank covenants.

## **SELECTED QUARTERLY INFORMATION**

### **Financial Highlights**

<b>\$000's except per share amounts</b>	<b>Mar 31, 2009</b>	<b>Dec 31, 2008</b>	<b>Sep 30, 2008</b>	<b>Jun 30, 2008</b>	<b>Mar 31, 2008</b>	<b>Dec 31, 2007</b>	<b>Sep 30, 2007</b>	<b>Jun 30, 2007</b>
Total revenue, net of royalty	<b>384</b>	392	567	798	535	483	409	576
Cash Flow (deficiency) from operations	<b>228</b>	170	(14)	88	116	(56)	(29)	(54)
Per share – basic and diluted	<b>0.01</b>	(0.02)	(0.00)	(0.00)	(0.00)	(0.001)	(0.003)	(0.003)
Net earnings (loss)	<b>100</b>	(420)	(212)	(72)	(18)	(23)	(223)	(197)
Per share – basic and diluted	<b>0.01</b>	(0.02)	(0.00)	(0.01)	(0.00)	(0.00)	(0.00)	(0.01)
Capital expenditures	<b>613</b>	439	428	274	74	401	(257)	(415)
Total assets	<b>7,053</b>	6,506	5,915	5,813	6,233	5,490	6,241	5,550
Net working capital (debt)	<b>(3,219)</b>	(2,641)	(2,301)	(2,697)	(2,494)	(2,536)	(400)	481