



Emerald Bay Energy

EMERALD BAY ENERGY, INC.

MANAGEMENT DISCUSSION AND ANALYSIS

**FOR THE YEAR ENDED
DECEMBER 31, 2006**

APRIL 30, 2007

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 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, 2006.

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.

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.

	For the three months ended		For the twelve months ended	
	Dec 31 2006 (\$)	Dec 31 2005 (\$)	Dec 31 2006 (\$)	Dec 31 2005 (\$)
Revenues (before royalties)	571,507	1,202,517	2,708,995	2,320,876
Research and Development costs	-	(2,080)	(292)	(179,790)
Net income (loss)	36,300	(74,308)	(733,563)	(863,310)
Net income (loss) per share (basic and diluted)	0.01	(0.01)	(0.03)	(0.05)
Total assets	5,390,613	6,705,341	5,390,613	6,705,341
Secured debt	750,000	2,000,000	1,107,224	2,000,000

During 2006, the Company participated in drilling 7 gross wells in Alberta, Saskatchewan and Texas, as part of an active drilling program using proceeds from Flow-through share offerings of 2005.

PRODUCTION

Emerald Bay recently completed its pipeline construction and tie-in operations in **Dorelee and Kelsey, Alberta**.

During the month of March 2007 the Company has averaged in excess of 220 BOEPD. By way of comparison, the Company last reported production of 171 boepd in Q3 2006.

PRODUCTION OPTIMIZATION & 2007 DEVELOPMENT FORECAST - ALBERTA

The Company is currently evaluating production bottlenecks that have us producing at constrained rates at Dorelee, Kelsey as well as Clive. It is the Company's goal to be fully optimized in these areas by the end of Q2 2007 which could potentially add 25 to 50 BOEPD.

Gilby, Alberta - The Company will continue with Phase 2 of the testing operations with three Jurassic intervals to be perforated and tested during this phase.

Clive, Alberta - Emerald Bay is currently reviewing trade seismic recently purchased to confirm the location for a Basal Belly River well on Company lands at 16-16-39-24 W4. The Company also plans to re-enter its two open-hole CBM wells in 14-39-24 W4 to case, cement, fracture-stimulate, and tie-in the wells to existing infrastructure. It is forecasted that the Clive operations will commence immediately after breakup.

Twining, Alberta - The Company completed and tied-in the 10-18-31-23 W4 well in the Ellerslie formation. Although production from the Ellerslie has not met expectations, Emerald Bay is very optimistic with the up-hole potential in the 10-18 well as well as the 16-18 well, and is moving forward with a program to complete the Mannville and Viking formations. Emerald Bay has also completed seismic operation over lands acquired at a land sale in the Twining area. .

Edson, Alberta - Emerald Bay continues to review its options on the Encana operated Edson 4-18-51-16 W5 in which it has a 20% working interest. The Scollard Coal formation is also being evaluated for up-hole potential in 2007. The Company participates in approximately 16 wells in the Edson area.

OTHER PROPERTIES

Testing operations continue in Maverick County on the Cypress Hills 604-1 well. Very encouraged by the results to date, the Company is working with its engineers, geophysicists, and geologists to determine the location and associated risk factors of well #2.

Completion operations were concluded in test well #1 that targeted the Mississippian Madison Group in Southwest Saskatchewan. This well did not have commercial quantities of producing hydrocarbons. Test well #2 will not be drilled at this time. Emerald Bay had a minority interest in this property and was relying on the operator and majority interest owner to participate in further exploration. The majority interest owner has declined to participate in the continuing development, therefore Emerald Bay will re-direct its efforts in Central Alberta.

Management expects to increase the Company's reserves, production, and cash flow during the remainder of 2007 and into 2008 as a result of the Company's optimization and 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.

SELECTED ANNUAL INFORMATION

Financial Highlights

	2006	2005	2004
Total revenue, net of royalty	2,066,516	1,777,127	732,210
Cash flow (deficiency) from operations	212,996	(260,876)	(618,095)
Per share – basic and diluted	0.01	(0.05)	(0.08)
Net loss	(733,563)	(863,310)	(981,108)
Per share – basic and diluted	(0.03)	(0.05)	(0.08)
Net capital expenditures	(1,867,187)	(64,343)	(291,012)
Total Assets	5,390,613	6,705,341	2,954,212
Net working capital (debt)	(1,262,760)	893,691	(1,847,899)
Common shares – Weighted average	27,868,806	16,158,956	11,708,304

SELECTED QUARTERLY INFORMATION

Financial Highlights

\$000's except per share amounts

	2006				2005			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Total revenue, net of royalty	485	532	388	662	880	330	330	237
Cash Flow (deficiency) from operations	83	104	(96)	121	58	(36)	(135)	(222)
Per share – basic and diluted	0.01	(0.003)	(0.003)	0.004	0.01	(0.004)	(0.01)	(0.02)
Net earnings (loss)	(261)	(164)	(367)	(246)	(74)	(133)	(322)	(334)
Per share – basic and diluted	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.01)
Net capital expenditures	(833)	198	(1,017)	(215)	454	89	138	(746)
Total assets	5,391	4,072	4,305	4,563	6,705	3,699	3,287	3,752
Net working capital (debt)	(1,263)	(388)	(782)	(1,910)	894	389	(194)	144

RESERVES

Emerald Bay engaged GLJ Petroleum Consultants Ltd. (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 2006 (based on GLJ constant pricing), total proved plus probable reserves in Canada increased 8% over the previous year to 390 thousand boe from 362 thousand boe, and the net present value of proved plus probable reserves (forecast pricing, before tax, discounted at

10%) increased 32% to \$7.59 million as at December 31, 2006 from \$5.77 million as at December 31, 2005. 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 2005	2006 Revisions	2006 Production	Dec 31 2006
Cdn Crude oil & NGL - bbl	57,000	12,000	(13,000)	56,000
Cdn Natural gas – mcf	1,829,000	479,000	(303,000)	2,005,000
Total BOE – Canada	362,000	78,000	(50,000)	390,000
US Crude Oil	8,100	5,900	(2,000)	12,000

DETAILED REVIEW OF FINANCIAL RESULTS

Net Earnings and Cash Flow

	For the three months ended		For the twelve months ended	
	Dec 31 2006 (\$)	Dec 31 2005 (\$)	Dec 31 2006 (\$)	Dec 31 2005 (\$)
Net earnings (loss)	(118,986)	(74,308)	(733,563)	(863,310)
Per share	(0.01)	(0.01)	(0.03)	(0.05)
Cash flow used from operation	(679)	175,292	212,996	(260,876)
Per share	0.01	0.01	(0.01)	(0.01)

The Company has recorded a net loss of \$733,563 for the twelve months ended December 31, 2006, compared to a net loss of \$863,310 for the year ended December 31, 2005. The majority of the net loss compared to 2005 relates to the increased depletion, depreciation and amortization expense as well as the stock based compensation and fair value allowance expenses. In addition a future tax recovery of \$306,000 in 2006 (2005 – nil).

Revenue

	For the three months ended		For the twelve months ended	
	Dec 31 2006 (\$)	Dec 31 2005 (\$)	Dec 31 2006 (\$)	Dec 31 2005 (\$)
Oil and NGLs	85,764	226,594	509,262	409,984
Per barrel	39.15	60.38	56.90	54.52
Natural gas	490,752	975,923	2,199,733	1,910,892
Per mcf	10.16	11.45	6.50	9.77
Total gross revenue	576,516	1,202,517	2,708,995	2,320,876
Per boe	57.51	66.94	44.91	57.84

Despite significantly lower than expected gas prices in 2006 gross revenue increased as compared to 2005 as the result of newly drilled wells being brought on production. Emerald Bay does not currently have any hedges in place.

Sales Volumes

	For the three months ended		For the twelve months ended	
	Dec 31 2006	Dec 31 2005	Dec 31 2006	Dec 31 2005
Crude oil – barrels per day	13	13	13	7
Natural gas – mcf per day	881	927	805	536
NGLs – barrels per day	15	27	21	13
BOE – barrels per day	175	195	168	110

Sales volumes increased to 168 boed from 110 barrels per day in 2006 due to production from the Twining and Clive wells.

Royalties

	For the three months ended		For the twelve months ended	
	Dec 31 2006 (\$)	Dec 31 2005 (\$)	Dec 31 2006 (\$)	Dec 31 2005 (\$)
Total royalties	124,080	367,420	749,817	618,588
Per boe	7.81	20.45	12.22	15.42
Percentage of revenue	21.5%	30.6%	27.6%	26.7%

Royalties for the twelve months ended December 31, 2006 increased due to the increase in total revenue as described above. Royalties increased as a percentage of revenue due to the price sensitivity of the Company's royalties. The royalties increased on a BOE basis due to the higher price per BOE in 2006 versus 2005. Higher sales values generally attract a higher royalty rate.

Production Expense

	For the three months ended		For the twelve months ended	
	Dec 31 2006 (\$)	Dec 31 2005 (\$)	Dec 31 2006 (\$)	Dec 31 2005 (\$)
Total production expenses	149,969	175,140	635,854	360,841
Per boe	9.44	9.75	10.36	8.99
Percentage of revenue	26.0%	14.6%	23.4%	15.5%

Production expenses increased on a per boe basis to \$10.36 from \$8.99 in 2005.

General and administrative expenses

	For the three months ended		For the twelve months ended	
	Dec 31 2006 (\$)	Dec 31 2005 (\$)	Dec 31 2006 (\$)	Dec 31 2005 (\$)
General and administrative expense	230,865	593,269	1,372,889	1,499,081

General and administrative expenses decreased in 2006 compared to 2005 despite increased exploration activities. The company does not capitalize any administrative costs.

Stock based compensation increased significantly in 2006 due to the issuance of 1,250,000 stock options in the first quarter that vested immediately. These options increased stock option expense for the year by \$95,035. Stock option expense for 2006 was \$180,745 as compared to 2005 of \$85,710.

Research and development expenses

	For the three months ended		For the twelve months ended	
	Dec 31 2006 (\$)	Dec 31 2005 (\$)	Dec 31 2006 (\$)	Dec 31 2005 (\$)
Research and development expenditures	148	2,080	292	179,790

Research and development expenses decreased substantially in the period ended December 31, 2006, compared to the period ended December 31, 2005. The Company has completed the Alpha test phase of the project and is currently seeking development partners through its subsidiary Reach Energy Innovations.

Depletion, depreciation and site restoration expense

	For the three months ended		For the twelve months ended	
	Dec 31 2006 (\$)	Dec 31 2005 (\$)	Dec 31 2006 (\$)	Dec 31 2005 (\$)
Depletion, depreciation and amortization	230,636	189,306	919,905	497,047
Asset Retirement Obligation - Accretion	1,970	4,967	7,879	19,677
Total	232,606	194,273	927,784	516,724

Depletion, depreciation and amortization increased in 2006 as compared to 2005 due to significantly higher capital costs added in the fourth quarter of 2006 as well as in increased depletion rate due to higher production volumes in 2006. Accretion increased in 2006 as compared to 2005 due to the ownership of an increased number of oil and natural gas wells and related facilities in 2006.

Taxes

	For the three months ended		For the twelve months ended	
	Dec 31 2006 (\$)	Dec 31 2005 (\$)	Dec 31 2006 (\$)	Dec 31 2005 (\$)
Future income tax expense (recovery)	(306,000)	-	(306,000)	-

At December 31, 2006, the Company had a future income tax asset of \$225,000 as compared to the 2005 future income tax asset of \$605,000. A valuation allowance has been set up for the portion of the future income tax asset that is not more likely than not to be realized in the future. A future income tax recovery of \$306,000 has been recorded in the current year.

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, 2006, there were 27,903,277 common shares issued and outstanding, and an additional maximum total of 1,179,904 reserved for issuance on the potential exercise of common share purchase options. During 2006 1,250,000 options were granted. In addition, 6,434,500 common shares may be issued on the exercise of warrants.

CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The Company operates its office under lease arrangement for Three (3) years commencing October 1, 2006 and ending September 30, 2009.

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 2 to the audited Financial Statements. 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 has counterclaimed for \$760,000 plus additional damages. In the opinion of management, the outcome of this action is not determinable at this time.

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. In the past year there have been strong examples of all of the above. On the political front there was the October 31, 2006 announcement of the federal government's intentions to tax income trusts. This event resulted in a significant erosion of value in the trust sector. As the trust sector had been the main exit strategy for junior oil and gas companies, this also resulted in a significant drop in the market value of the junior oil and gas sector. This event was not only distressing to shareholders of these companies, but also increased the effective cost of raising public equity.

Regulatory risk has been observed in the increased time required to obtain various approvals. Such delays result in projects being started later than planned or being brought on production later than planned.

Perhaps the most significant risk that will be faced by the industry in the coming years is the environmental risk. This risk perhaps should be labeled the political environmental risk. There have been various rumours of carbon, or other green taxes or measures that would adversely affect the industry and therefore Emerald Bay. Emerald Bay welcomes well thought out measures to improve and make cleaner the world that we all live and work in. However, Emerald

Bay would be remiss not to mention the risk that hasty legislation may have a significant adverse effect on the industry and therefore, the company.

DISCLOSURE CONTROLS AND PROCEDURES OVER FINANCIAL REPORTING

Disclosure controls and procedures are designed to provide reasonable assurances that all relevant information is gathered and reported to senior management, including the Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”), and that management has evaluated the effectiveness of the Corporation’s disclosure controls and procedures as defined in Multilateral Instrument 52-109 of the Canadian Securities Administrators and has concluded that such disclosure controls and procedures are effective. However, they do not expect that the disclosure controls and procedures or internal control over financial reporting will prevent all errors or fraud. An economically feasible control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The CEO and CFO of Emerald Bay Energy are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The company assessed the design of its internal control over financial reporting as of December 31, 2006. During this process, management identified certain weaknesses in internal controls over financial reporting which are as follows:

- Due to the limited number of staff at Emerald Bay, it is not economically feasible to achieve complete segregation of incompatible duties.
- Due to the limited number of staff, the Corporation does not have a sufficient number of financial personnel with the technical accounting knowledge to address all complex and non-routine accounting transactions that may arise.

These weaknesses in internal controls over financial reporting result in a possibility that a material misstatement would not be prevented or detected. Management and the board of the directors work to mitigate the risk of a material misstatement in financial reporting. However, there can be no assurance that this risk can be reduced to less than a remote likelihood of a material misstatement.