



# *Emerald Bay Energy*

**EMERALD BAY ENERGY, INC.**

**MANAGEMENT DISCUSSION AND ANALYSIS**

**FOR THE QUARTER ENDED  
MARCH 31, 2006**

**MAY 30, 2006**

## MANAGEMENTS' DISCUSSION AND ANALYSIS

The following discussion and analysis of financial information and related data concerning Emerald Bay Energy, Inc. is reported in Canadian dollars and the financial data presented has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), and should be read in conjunction with the unaudited financial statements for the quarter ended March 31, 2006, and the audited financial statements for the year ended December 31, 2005.

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 assumptions 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

#### OIL AND GAS OPERATIONS

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 2006 (\$)	Mar. 31 2005 (\$)
Revenues (before royalties)	935,520	308,444
Research and Development costs	-	(67,932)
Net income (loss)	(246,450)	(334,348)
Net income (loss) per share (basic and diluted)	(0.01)	(0.03)
Cash flow used from operations	121,369	(222,199)
Per share	0.004	(0.02)
Total assets	4,563,071	3,751,951
Secured term debt	-	390,000

The Company has recorded a net loss of \$246,450 for the first quarter, compared to a net loss of \$334,348 for the same period in the prior year. Cash flow increased from a deficit of \$222,199 in 2005 to a surplus in 2006 of \$121,369. It is worth noting that \$169,072 of the difference between cash flow and net income in the first quarter related to stock option expense.

The increase in revenues resulted in positive cash flow from operations. This milestone will allow the company to begin to use internal resources to fund exploration and development rather than equity as has been the case in the past.

During the period the Company continued an active exploration program that included data collection and geophysical analysis. The Company is now prepared for an active drilling program during the remainder of 2006.

At Twining, the Company is in the process of completing an extensive geological and seismic review. This process will be a valuable resource to the Company in identifying drilling targets in the Twining area. The Company has commenced drilling operations as of May 2006. Additionally, the Company is currently negotiating multiple farm-in opportunities in the Twining/Three Hills area for further exploration this year.

At Edson, the Company is moving forward with a plan to re-complete a Cardium well, drilled with Tom Brown Resources (now part of Encana Corporation) and Devon Energy. Completion options are being reviewed with anticipation of this work to begin sometime in June or July 2006.

At Clive, the Company is working to maximize current production by reducing capacity constraints on transmission lines. Increased activity in the area continues to make operators look for cost effective tie-in options to optimize production. The Company is currently working to route two wells into the pipeline infrastructure. The company has recently completed a tie-in of one well with the other two wells anticipated to begin production in the second quarter 2006.

Emerald Bay's geological, engineering and land team continue to evaluate other development and exploration prospects in Alberta, British Columbia and South Texas.

Management expects to increase the Company's reserves, production, and cash flow during the remainder of 2006 and into 2007 as a result of the Company's 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.

## DETAILED REVIEW OF FINANCIAL RESULTS

### *Revenue*

**For the three months ended**

	Mar. 31 2006 (\$)	Mar. 31 2005 (\$)
Oil and NGLs	248,132	72,053
Per barrel	52.05	49.59
Natural gas	666,290	252,048
Per mcf	12.19	7.60
Total gross revenue	914,422	324,101
Per boe	52.93	46.44

## **Sales Volumes**

**For the three months ended**

	Mar. 31 2006	Mar. 31 2005
Crude oil – barrels per day	12	7
Natural gas – mcf per day	834	368
NGLs – barrels per day	41	9
BOE – barrels per day	192	78

Gross revenue increased for the quarter as compared to 2005 as a result of increased sales volumes and prices. Sales volumes for the quarter as represented by BOE increased as a result of the Company's 2004/2005 drilling programs.

### ***Royalties***

During the first quarter, Emerald Bay's royalties of \$273,580 represented 29.2% of revenues, up from \$71,213 and 23.1% of revenues in the same period in the prior year.

### ***Production Expense***

Production expenses of \$162,227 in the first quarter were incurred at a rate of \$9.39 per BOE of sales volume, up from \$61,982 and \$8.88 in the same period in the prior year as a result of services performed on certain wells.

### ***General and administrative ("G&A") expenses***

G&A costs of \$327,981 in the first quarter were comparable to \$327,093 in the same period in the prior year.

### ***Stock Option Expense***

Stock options expenses for the period totaled \$169,072 relating to the issuance of 1,250,000 stock options which vested immediately.

### ***Research and development ("R&D") expenses***

There were no R&D expenses for the period ended March 31, 2006. There were R&D expenses totaling \$67,932 for the same period in the prior year. The decrease is a result of the transition of the company to separate the LDD technology into a subsidiary, which is intended to become separately funded.

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

Depletion, depreciation and amortization ("DD&A") costs of \$198,747 were incurred in the first quarter, up from \$104,807 in the same period the in prior year. This represents a decrease to \$11.50 per BOE from \$14.93 per BOE in the first quarter of 2005.

## **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. The company has a \$2.4 million credit facility available and unused at the end of the period.

## **TAXES**

Emerald Bay is not subject to current income tax. At March 31, 2006, its estimated tax pools were approximately \$4.6 million.

## **SHAREHOLDERS EQUITY**

As at March 31, 2006, there were 27,637,277 common shares issued and outstanding, and an additional maximum total of 2,429,904 reserved for issuance on the potential exercise of common share purchase options. In addition, 8,628,278 common shares may be issued on the exercise of warrants.

## **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 6 of the audited Financial Statements for the fiscal year ended December 31, 2005 fully detail Emerald's related party transactions.