

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management's Discussion and Analysis (MD&A) should be read in conjunction with Emerald Bay Energy Inc. (the "Company") Interim Consolidated Financial Statements for the three months ended March 31, 2014 and the audited annual Consolidated Financial Statements for the year ended December 31, 2013. Certain information regarding the Company contained herein may constitute forward-looking statements under applicable securities laws. Such statements are subject to known or unknown risks and uncertainties that may cause actual results to differ materially from those anticipated or implied in the forward-looking statements.

Additional information relating to the Company is available on SEDAR at www.sedar.com. The Company is listed on the Canadian Stock Exchange under the symbol "EBY". The MD&A is dated May 30, 2014.

BASIS OF PRESENTATION

The financial data presented below has been prepared in accordance with International Financial Reporting Standards. All amounts are reported in Canadian dollars unless otherwise indicated.

Application of Accounting Estimates

The significant accounting policies used by the Company are disclosed in Note 3 to the annual Consolidated Financial Statements for the year ended December 31, 2013. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a periodic basis. The emergence of new information and changed circumstance may result in actual results or changes to estimates that differ materially from current estimated amounts.

Non-IFRS and Non-GAAP Measures

This MD&A includes the following measures that are from time to time used by the Company, but do not have any standardized meaning under IFRS and may not be comparable to similar measures presented by other companies:

- a) "Funds from operations" - should not be considered an alternative to, or more meaningful than "cash flow from operating activities" as determined in accordance with IFRS as an indicator of the Company's financial performance. Funds from operations is determined by adding non-cash expenses to the net income or loss for the period, deducting decommissioning liability expenditures and does not include the change in working capital applicable to operating activities. Management believes that in addition to cash flow from operating activities, funds from operations is a useful supplemental measure as it provides an indication of the results generated by the Company's principal business activities before the consideration of how such activities are financed.
- b) "Operating netback" - Operating netbacks are calculated by deducting royalties and operating costs, including transportation costs, from revenues.
- c) "Working capital" – working capital includes total current assets and total current liabilities. The working capital ratio is calculated by deducting total current liabilities.

Going Concern

At March 31, 2014, the Company had not yet achieved profitable operations, had accumulated a deficit of \$16,084,539 since its inception (December 31, 2013 - \$15,929,544), had negative cash flows from operations of \$89,396 (December 31, 2013 - \$19,622) and had a working capital deficiency of \$4,752,397 (December 31, 2013 - \$4,445,030) (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 Interim 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 Interim Consolidated Financial Statements if the Company ceases to be a going concern could be material.

BOE Presentation

The term "barrels of oil equivalent" (BOE) may be misleading, particularly if used in isolation. A BOE conversion of six thousand cubic feet of natural gas to one barrel of oil (6:1) is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Readers should be aware that historical results are not necessarily indicative of future performance.

FORWARD-LOOKING STATEMENTS

Certain statements contained within the Management's Discussion and Analysis, and in certain documents incorporated by reference into this document, constitute forward looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward looking statements. Forward looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward looking statements.

In particular, this MD&A may contain the following forward looking statements pertaining to, without limitation, the following:

The Company's future production volumes and the timing of when additional production volumes will come on stream; the Company's realized price of commodities in relation to reference prices; the Company's future commodity mix; future commodity prices; the Company's expectations regarding future royalty rates and the realization of royalty incentives; the Company's expectation of future operating costs on a per unit basis; future general and administrative expenses; future development and exploration activities and the timing thereof; the future tax liability of the Company; the expected rate of depletion, depreciation and accretion; the estimated future contractual obligations of the Company; the future liquidity and financial capacity of the Company; and, the Company's ability to fund its working capital and forecasted capital expenditures. In addition, statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future.

With respect to the forward looking statements contained in the MD&A, the Company has made assumptions regarding: future commodity prices; the impact of royalty regimes and certain royalty incentives; the timing and the amount of capital expenditures; production of new and existing wells and the timing of new wells coming on-stream; future proved finding and development costs; future operating expenses including processing and gathering fees; the performance characteristics of oil and natural gas properties; the size of oil and natural gas reserves; the ability to raise capital and to continually add to reserves through exploration and development; the continued availability of capital, undeveloped land and skilled personnel; the ability to obtain equipment in a timely manner to carry out exploration and development activities; the ability to obtain financing on acceptable terms; the ability to add production and reserves through exploration and development activities; and, the continuation of the current tax and regulation.

We believe the expectations reflected in forward looking statements contained herein are reasonable but no assurance can be given that these expectations will prove to be correct and such forward looking statements included in, or incorporated by reference into, this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A or as of the date specified in the documents incorporated by reference into this Management's Discussion and Analysis, as the case may be. The actual results could differ materially from those anticipated in these forward looking statements as a result of the risk factors set forth below and elsewhere in this MD&A, which include volatility in market prices for oil and natural gas; counterparty credit risk; access to capital; changes or fluctuations in production levels; liabilities inherent in oil and natural gas operations; uncertainties associated with estimating oil and natural gas reserves; competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel; stock market volatility and market valuation of the Company's stock; geological, technical, drilling and processing problems; limitations on insurance; changes in environmental or legislation applicable to our operations, and our ability to comply with current and future environmental and other laws; changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry, changes in the regulatory regimes under which the Company operates, changes in the political and social environment that may impact the Company and the other factors discussed under "Risk Factors" in the following annual MD&A. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward looking statements contained in this MD&A and the documents incorporated by reference herein are expressly qualified by this cautionary statement. The forward looking statements contained in this document speak only as of the date of this document and the Company does not assume any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable securities laws.

SELECTED YEAR TO DATE FINANCIAL INFORMATION

	Three months ended March 31	
	2014	2013
FINANCIAL		
Gross revenue	27,146	22,636
Total assets	3,075,224	2,953,204
Cash flows used in operations	89,396	46,792
Net comprehensive loss	154,995	222,664
Per share – basic and diluted	(0.00)	(0.00)
Capital expenditures	2,476	19,434
Exploration and evaluation expenditures	73,367	115,595
Loan	1,300,000	1,152,662
OPERATIONS		
Production sales		
Oil (BBLs/d)	1	1
Natural gas (MCF/d)	68	34
NGL (BBLs/d)	-	-
Total (BOE/d @ 6 MCF: 1 BBL)	12	7
Average pricing		
Natural gas (\$/MCF)	3.92	2.62
Oil and NGL's(\$/BBL)	103.27	110.70
Combined (\$/BOE)	25.77	35.27
Expenses		
Production expense & transportation (\$/BOE)	28.32	13.93
Royalty expense (\$/BOE)	1.64	(0.40)
Net Back Combined (\$/BOE)	(4.19)	21.74

Financial and Operations Results

Revenue from the sale of petroleum and natural gas is recorded on a gross basis when title passes to an external party and is recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including production, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

Petroleum and natural gas revenue was \$27,146 for the three months ended March 31, 2014, from revenue of \$22,636 for the three months ended March 31, 2013.

Natural gas prices increased to \$3.92/MCF in the three months ended March 31, 2014 versus \$2.62/MCF for the three months ended March 31, 2013. Oil and NGL combined prices decreased to \$103.27 in the three months ended March 31, 2014 from \$110.70 in the three months ended March 31, 2013. The average sales price on a BOE basis was \$25.77 in the three months ended March 31, 2014, compared to \$35.27 in the three months ended March 31, 2013.

During the three months ended March 31, 2014, the average sales volume on a BOE/d basis increased to 12 BOE/d, compared with 7 BOE/d during the three months ended March 31, 2013.

During the three months ended March 31, 2014, cash flows used in operations increased to \$89,396 from \$46,792 during the three months ended March 31, 2013.

Period over period, the Company's revenue remained flat. Certain Canadian assets remained shut-in to preserve existing reserves while the natural gas prices remain low. The Canadian assets will remain shut-in and additional natural gas drilling programs within Canada will remain on hold until prices rebound. During the fourth quarter of the year ended December 31, 2013, the Company sold its remaining property and equipment, and accordingly recorded no revenue from these properties in 2014.

OPERATING RESULTS

	Average Daily Volumes		Average Prices	
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013
Natural Gas (MCF/d)	68	34	3.92	2.62
Oil (BBLs/d)	1	1	102.20	110.84
NGL (BBLs/d)	-	-	-	-
Barrels of Oil Equivalent (BOE)	12	7	25.77	35.27

During the three months ended March 31, 2014, the Company continued to focus its resources toward its exploration program in Guadalupe County, Texas. For the three months ended March 31, 2014 natural gas sales increased to 68 MCF/d compared to 34 MCF/d the previous period due to higher natural gas prices during the current period, which enabled the Company to slightly increase its production to realize on the higher prices. However, a significant portion of the Canadian assets remain shut-in during the current period to preserve existing reserves while the natural gas prices remain low, as well as previously drilled wells not being brought on line until natural gas prices rebound.

Natural gas prices increased during the three months ended March 31, 2014 to \$3.92/MCF versus \$2.62/MCF during the same period in 2013.

Oil production for the three months ended March 31, 2014 remained constant at 1 BBLs/d when compared to the three months ended March 31, 2013, primarily due to the sale of the remaining US producing assets in the fourth quarter of 2013 and the Company's focus on the exploration project in Texas.

During the three months ended March 31, 2014, the average price received for oil was \$102.20/barrel versus \$110.84/barrel during the three months ended March 31, 2013. The majority of the Company's production is medium viscosity crude which receives higher pricing.

NGL sales on a daily basis remained negligible, generating only minimal revenue of \$32 during the three months ended March 31, 2014. The average NGL price remained the same as the three months ended March 31, 2013.

During the three months ended March 31, 2014, the average sales volume on a BOE/d basis increased to 12 BOE/d compared with 7 BOE/d for the three months ended March 31, 2013.

The average sales price on a BOE basis was \$25.77/BOE during the three months ended March 31, 2014, decreasing from \$35.27/BOE received in the three months ended March 31, 2013.

On a barrel of oil equivalent basis, during the three months ended March 31, 2014 oil and NGL accounted for 8% of total sales and natural gas accounted for 92% of total sales, compared to the three months ended March 31, 2013 when oil and NGL accounted for 14%, with natural gas accounted for 86% of total sales.

FINANCIAL RESULTS

Revenue from the sale of petroleum and natural gas is recorded on a gross basis when title passes to an external party and is recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including production, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

Three months ended March 31,	2014 (\$)	2013 (\$)
Petroleum and natural gas revenue	27,146	22,636
Royalties, petroleum and natural gas	(1,729)	258
Production expenses, petroleum and natural gas	(29,827)	(8,942)
Operating netback, petroleum and natural gas	(4,410)	13,952
Net loss	(154,995)	(222,664)
Net loss per share (basic and diluted)	(0.00)	(0.00)
Revenue per BOE	25.77	35.27
Royalty per BOE	1.64	(0.40)
Operating costs per BOE	28.32	13.93
Operating netback per BOE	(4.19)	21.74

Petroleum and natural gas revenue increased to \$27,146 for the three months ended March 31, 2014 from revenue of \$22,636 during the three months ended March 31, 2013. Revenue on a BOE basis decreased to \$25.77/BOE from \$35.27 during the three months ended March 31, 2013.

Royalties increased to \$1,729 during the three months ended March 31, 2014 compared to the same period in 2013 of a recovery of \$258. Royalty per BOE for the three months ended March 31, 2014 averaged \$1.64/BOE, which was an increase from \$(0.40)/BOE during the three months ended March 31, 2013.

Production expenses in the three months ended March 31, 2014 increased to \$29,827 from the three months ended March 31, 2013 of \$8,942. Operating costs/BOE for the three months ended March 31, 2014 increased to \$28.32/BOE from \$13.93/BOE in the three months ended March 31, 2013.

Operating netback from petroleum and natural gas sales decreased to (\$4,410) during the three months ended March 31, 2014 from 13,952 during the three months ended March 31, 2013.

Operating netback/BOE decreased to (\$4.19)/BOE from \$21.74/BOE.

The Company's slight revenue increase was due to the increase in the natural gas prices realized on the operating Canadian assets during the three months ended March 31, 2014 compared the same period in 2013. The increase was offset by certain Canadian assets continuing to be shut-in to preserve existing reserves while the natural gas prices remain low combined with the fourth quarter disposal of the remaining producing assets in the Somerset and Taylor-Ina counties. Operating costs increased as a proportion of revenue as the Company continues to focus on its exploration assets in Texas where it has incurred certain miscellaneous operating expenses. These factors also contributed to the negative operating netback during the current period.

Royalties per unit of Production		
Three months ended March 31,	2014	2013
Gas (\$/MCF)	0.26	(0.25)
Oil (\$/BBL)	3.97	5.33
NGL (\$/BBL)	-	-
Total (\$/BOE)	1.64	(0.40)

The royalties per MCF for natural gas increased to \$0.26/MCF from (\$0.25)/MCF in 2013. Oil royalties decreased to \$3.97/BBL from \$5.33/BBL in 2013. Combined royalties for all products decreased to \$1.64/BOE in 2013 from a recovery of (\$0.40)/BOE the previous period.

GENERAL & ADMINISTRATIVE EXPENSES

After recoveries, general and administrative expenses (“G&A”) decreased to \$129,327 during the three months ended March 31, 2014 from \$209,980 for the same period during 2013. The decrease in the Company’s G&A is reflective of the Company’s efforts to control overhead cost while it continues to expand its activities and progress with the exploration program in Texas.

	Three months ended March 31,	
	2014 (\$)	2013 (\$)
Net G&A Expenses	129,327	209,980

STOCK BASED COMPENSATION

During the three months ended March 31, 2014, there were no stock option grants, cancellations, exercises, or expiries. Compensation expense of \$4,929 was recognized during the three months ended March 31, 2014 (March 31, 2013 - \$nil).

DECOMMISSIONING LIABILITIES

Decommissioning liabilities are the present value of management’s estimate of future costs to be incurred to properly abandon and reclaim the properties held by the Company. Accretion expense is the increase in the decommissioning liability resulting from the passage of time. Decommissioning liabilities increased from \$559,751 as at December 31, 2013 to \$608,038 as at March 31, 2014. The increase was primarily due to the accretion incurred and the change in risk-free rates during the period.

DEPLETION & DEPRECIATION

Depletion and depreciation expense, an accounting measure of our finding and on-stream costs, is calculated using the ratio of capital costs to proven reserves. Capital costs include the net book value of historical costs incurred and estimated future expenditures to develop proved reserves.

	Three months ended March 31,	
	2014 (\$)	2013 (\$)
Depletion and depreciation	21,862	18,973

During the three months ended March 31, 2014, depletion and depreciation expenses increased to \$21,862 compared to \$18,973 during the same period in 2013. The increase was primarily due to increased production in the operating Canadian assets, reflecting the higher gas prices, and lower reserve base.

CASH FLOWS FROM OPERATIONS

During the three months ended March 31, 2014, cash flows used in operations increased to \$89,396 from \$46,792 during the same period in 2013. This increase was primarily due to working capital fluctuations.

Funds used in operations during the three months ended March 31, 2014 decreased to \$218,479 from the previous year's \$223,815. The decrease in funds used in operations was predominately due to lower general and administrative expenses, offset by higher operating costs during 2014 as compared to 2013.

CAPITAL EXPENDITURES

	Three months ended March 31,	
	2014 (\$)	2013 (\$)
Exploration and evaluation expenditure	73,367	115,595
Capital expenditures	2,476	19,434

The exploration and evaluation expenditures related to the Company's exploration program in Texas have decreased period over period as the Company nears completion of costs required in the exploration stage of the program before the assets enter the developed stage. The assets have yet to show technological feasibility and commercial viability and accordingly are considered exploration and evaluation assets.

The slight decrease in capital expenditures during 2014 as compared to 2013 continue to reflect the low natural gas prices, which continue to delay certain projects in Canada until there is a rebound in the commodity price. Capital expenditures during the period are primarily lease rental payments.

EQUITY INVESTMENT IN PRI

The Company holds a 25% equity interest in Production Resources Inc ("PRI"), and records 25% of PRI's net income or loss into its records. During the three months ended March 31, 2014, the Company's portion of PRI's net income was \$42,782, which has been reflected into the Company's comprehensive loss (March 31, 2013 – \$55,928). The decrease in PRI's net income was primarily due to increased non-cash items including depletion and accretion costs, off-set by higher netbacks generated through: (i) two acquisitions during the fourth quarter of the year ended December 31, 2013 whereby PRI acquired approximately 150 wells; and (ii) 10 new wells drilled during 2013. It is anticipated that PRI will drill an additional 10 wells during 2014.

QUARTERLY FINANCIAL INFORMATION

The following is a summary of selected quarterly information that has been derived from the unaudited Consolidated Financial Statements of the Company. This summary should be read in conjunction with unaudited Consolidated Financial Statements of the Company as contained in the public record.

Quarterly Financial Information (\$000 except per share and unit values)	Mar 31 2014	Dec 31 2013	Sept 30 2013	Jun 30 2013	Mar 31 2013	Dec 31 2012	Sep 30 2012	Jun 30 2012
Petroleum and natural gas sales	27	28	63	55	23	12	46	27
Net loss	(155)	(1,306)	(258)	(362)	(223)	(567)	(305)	(641)
Net loss per share								
Basic and diluted	(0.00)	(0.01)	(0.00)	(0.00)	(0.00)	(0.01)	(0.00)	(0.01)
Average daily sales								
Natural gas (MCF/d)	68	56	26	59	34	46	16	14
Oil/NGL (BBLs/d)	1	2	6	4	1	-	6	4
Barrels of oil equivalent (BOE/d)	12	11	10	14	7	8	8	7
Average sales prices								
Natural Gas (\$/MCF)	3.92	2.99	2.80	3.93	2.62	3.19	1.59	1.68
Oil/NGL (\$/BBL)	103.27	90.71	99.24	89.35	110.70	(17.10)	85.70	60.55
Barrels of oil equivalent (\$/BOE)	25.77	28.23	65.49	43.07	35.27	16.17	61.16	43.19
Operating costs (\$/BOE)	28.32	43.95	50.72	27.81	13.93	83.00	51.58	116.72
Royalty Expense (\$/BOE)	1.64	3.36	3.42	5.02	(.40)	28.50	1.16	(19.84)
Operating netback (\$/BOE)	(4.19)	(19.08)	11.35	10.24	21.74	(95.33)	8.42	(53.69)

Explanation of Quarterly Variances

On a quarter by quarter basis, production volumes, and accordingly petroleum and natural gas sales, have remained minimal, with little fluctuation. During 2011, the Company sold a significant portion of the Canadian assets and as natural gas prices decreased significantly, certain of the remaining Canadian assets were shut-in until such time as commodity prices begin to increase.

Net comprehensive loss increased during the fourth quarter for both the year ended December 31, 2013 and December 31, 2012, primarily due to the impairment of property and equipment taken during both years and during 2012, the recognition of the shareholder indemnities. During the fourth quarter of 2013, the Company issued stock options and recorded a share-based payment expense, contributing to the rise in the fourth quarter net loss.

The impairments have all been recognized in the fourth quarter.

LIQUIDITY & CAPITAL RESOURCES

In order to resolve its working capital deficiency of \$4,752,397, and to access additional share equity, the Company will continue to emphasize its exploration program in Texas. The Company's Texas prospects should produce better returns due to higher oil prices compared with natural gas, greater drilling potential and more locations. Given the Company's recurring operating losses it is critical that the Company refocus to an area with the potential for growth, positive cash flow and income, which is considered to exist in the Texas assets.

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"). During the three months ended March 31, 2014, the Lender advanced an additional \$100,000 to the Company under the same terms as the New Loan. Included in the New Loan is a conversion feature, which at the option of the Lender, and subject to regulatory approval, the entire principal amount of the New Loan, or any portion outstanding, may be converted to shares in the Company at a price of \$0.05 per common share until August 15, 2014. As of March 31, 2014 and up to the date of this MD&A, the conversion feature had not yet received regulatory approval.

The Company may, at any time, repay the loan in full without notice or penalty. If the Company is in default of the requirements included in the New Loan agreement or the Lender believes the Company's ability to repay the loan is impaired, the Lender may demand repayment of the loan or accelerate the date for payment. During the three months ended March 31, 2014, the Company incurred interest of \$30,000 (December 31, 2013 - \$120,000).

Pursuant to the Original Loan Agreement, the Company issued to the Lender 5,000,000 share purchase warrants (the "Original Warrants"). The Original Warrants were valued at \$147,195 and were treated as a transaction cost, and accordingly were netted against the principal balance of the loan, which was accreted back up to the principal balance at the maturity date. On August 15, 2013, the Original Warrants expired unexercised. Pursuant to the New Loan agreement, the Company issued to the Lender 5,000,000 share purchase warrants (the "New Warrants"). Each New Warrant is 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. As of March 31, 2014, the New Warrants had not yet received regulatory approval and therefore will not be valued until such time as approval is received. Subsequent to March 31, 2014, regulatory approval was received.

Security for the loan consists of a \$1,500,000 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.

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, 2013 and January 1, 2014, it was mutually agreed upon between the Lender and the Company to extend the loan under the same terms for an additional year. During the three months ended March 31, 2014, the Lender advanced an additional loan amount of \$100,000 USD to the Company under the same terms as the Loan Agreement. The proceeds of the loan were used to continue the Company's exploration program in Texas. Interest on the loan is 12% per annum, payable monthly, on the outstanding principal amount and compounds monthly. During the three months ended March 31, 2014, the Company incurred interest of \$4,866 (December 31, 2013 - \$19,726).

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.

At December 31, 2013, the loan had matured and on the January 1, 2014 extension, the terms of the conversion feature were changed to establish the conversion price to be the market price of the Company's shares on January 1, 2014. All other terms and conditions remain the same. As of March 31, 2014, and up to the date of this MD&A, the conversion feature on the January 1, 2014 extension had not yet received regulatory approval.

OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares issuable in series. As of the date hereof, the Company's issued share capital and the outstanding securities that are convertible into or exercisable or exchangeable for any voting or equity securities of the Company is as follows

	<u>May 30, 2014</u>	<u>March 31, 2014</u>
Common Shares	140,671,689	140,671,689
Warrants (i)	42,630,000	37,630,000
Stock Options (ii)	14,030,000	14,030,000

Notes:

- i) 29,680,000 of the warrants entitle the holder to acquire one additional common share for \$0.10 per share until October 25, 2013. 7,950,000 of the warrants entitle the holder to acquire one additional common share for \$0.10 per share until April 4, 2013. 5,000,000 of the warrants entitle the holder to acquire one additional common share for \$0.10 per share until August 15, 2014.
- ii) 2,405,000 of the Stock Options entitle the holders to acquire an equal number of common shares at \$0.10 per share until April 6, 2015. 4,925,000 of the Stock Options entitle the holders to acquire an equal number of common shares at \$0.10 per share until August 25, 2016. 6,700,000 of the Stock Options entitle the holders to acquire an equal number of common shares at \$0.05 per share until October 18, 2018.

OFF BALANCE SHEET ARRANGEMENTS

The Company is not party to any arrangements that would be excluded from the balance sheet.

RELATED PARTIES

a) The following amounts are due from related parties:

	March 31, 2014	March 31, 2013
	\$	\$
Note receivable from officer (i)	246,336	239,781
Fair value allowance (ii)	(240,789)	(216,515)
Net note receivable	5,547	23,266
Advance fees (iii)	6,529	6,529
	12,076	29,795

- (i) A promissory note was issued to an officer of the Company bearing interest at 3% per annum and there is 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. The note is secured by 393,000 common shares of the Company which had a fair value of \$3,930 at March 31, 2014 (December 31, 2013 - \$3,930).
- (ii) The fair value allowance was initially determined on December 31, 2013 based on the market value of the secured shares as the carrying value of the promissory note exceeded the fair value of the 393,000 common shares held as security.
- (iii) During the year ended December 31, 2008, a director was advanced \$59,473 in relation to efforts to finance and advance the Company's drilling technology. At March 31, 2014 \$6,529 (December 31, 2013 - \$6,529) remains outstanding. There is no guarantee that such efforts will be successful and if such efforts are not successful, the full balance will be repaid. The original repayment date of December 31, 2010 has been extended to December 31, 2014.

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

- (i) Aggregate fees of \$nil (March 31, 2013 - \$3,150) were charged by directors of the Company, all of which was recorded in the statement of comprehensive loss.
- (ii) Aggregate fees of \$nil (March 31, 2013 - \$12,000) were charged by a U.S. corporation, which is owned and controlled by an officer and a director of the Company for costs it incurred for operation of the Company's U.S. properties, all of which was recorded in the statement of comprehensive loss.
- (iii) Aggregate fees of \$8,616 (March 31, 2013 - \$8,514) were charged by corporations, which are owned and controlled by other equity investors in PRI, and were all recorded as general and administrative costs.
- (iv) Included in accounts payable at March 31, 2014 was \$140,416 owing to officers of the Company (December 31, 2013 - \$120,574).

All related party transactions are in the normal course of operations and have been measured at the agreed exchange amounts, which is the amount of consideration established and agreed to by the related parties and which is similar to those negotiated with third parties.

COMMITMENTS

- a) On January 15, 2012, 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 January 31, 2015.
- b) The Company has entered into various vehicle loan agreements with total annual principal repayments for fiscal years 2014 and 2015 as follows: \$26,109 and \$15,869.
- 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 \$331,551 at March 31, 2014 (December 31, 2013 - \$331,551). The Company has also estimated a potential liability for penalties and taxes on the amounts of \$45,897 (December 31, 2013 - \$45,897) 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.

RISK FACTORS AND RISK MANAGEMENT

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

Commodity Price Risk

The Company has sold its entire product on the spot market. While the Company currently has no hedges in place, historically the Company has participated in these contracts when it is considered beneficial.

Production Risk

The Company believes it has a stable production base from a variety of wells. However, the Company remains subject to the risk that a significant decrease in production from some wells could result in a material decrease in the Company's production and associated cash flow.

Reserve Replacement Risk

The Company's production is subject to natural declines and the Company plans to replace production with acquisitions and developing new reserves. To remain financially viable, the Company must be able to replace reserves at a lesser cost on a per unit basis than its cash flow on a per unit basis. The Company closely monitors the capital expenditures made for the purpose of increasing its petroleum and natural gas reserves.

Regulatory Risk

Government royalties, income tax laws, environmental laws and regulatory requirements can have a significant impact on the Company's finances and operations. The Company strives to remain knowledgeable regarding changes to the regulatory regime under which it operates, in both Canada and the United States. Sudden regulatory or royalty changes by future government action is unpredictable and cannot be forecast by the Company.

Climate Change Risk

North American climate change policy is evolving and changing at both regional and national levels. The Company expects that some of its operations may be subject to future regional, provincial and/or federal climate change regulations to manage greenhouse gas. The exact scope and timing of new climate change measures is difficult to predict.

FINANCIAL INSTRUMENTS

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.

(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, and long-term debt. The fair values of the Company's financial instruments approximate the carrying values.

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, 2014, 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 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, 2014, the Company's trade and other receivables have been aged as follows:

Days outstanding	March 31, 2014	December 31, 2013
	\$	\$
0-30 days	16,880	67,653
31-60 days	1,276	6,204
61-90 days	929	56,561
Greater than 90 days	406,008	330,669
Total	425,093	461,087

\$406,008 of the Company's trade and other receivables are considered past due. However, the Company deems all amounts as collectible and as such, a provision for doubtful accounts has not been recorded at March 31, 2014 (December 31, 2013 - \$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, 2014, the Company's maximum exposure to liquidity risk is the total current liabilities of \$5,609,078 (December 31, 2013 - \$5,183,119).

The current liabilities and commitments are due as follows:

Accounts payable and accrued liabilities	3,672,676	Due within 90 days
Loan (note 8)	1,300,000	Maturity date of August 15, 2014
Convertible debt (note 9)	276,375	Maturity date of December 31, 2014
Current portion of long-term debt (note 13(b))	26,476	Due within 12 months
Long-term debt (note 13(b))	9,110	Due within 24 months
Shareholder indemnities (note 13(c))	333,551	Due on demand

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.

(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.

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, 2014, 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 \$27,799 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, 2014, all of the Company's debt, including the loan and the convertible debt, 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 three months ended March 31, 2014.

(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.

OUTLOOK

Based on the continuation of low natural gas prices, the Company will continue to focus on the exploration program in Texas, which is an oil based resource. The initial impact of this transition shows a lower production volume in our overall output, but the increases in Oil output are starting to show. The daily production rates in the Company's PRI affiliate is not reported in the Company's average daily production rate. These volumes will be periodically reported through press releases after we are confident we have completed our land acquisition efforts in the area.

The Company will continue to pursue a carefully designed capital expenditure program, including acquisitions and dispositions, which would allow us to add production, reserves and cash flow in a cost effective manner while maintaining a level of flexibility in our balance sheet. We are confident that we have prepared ourselves to emerge from this environment operationally strong, and we expect to be well positioned to respond quickly when the business environment improves. Our proven management and dedicated team of professionals are engaged and committed to developing our high-quality asset base.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Consolidated Financial Statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. By their nature, these estimates are subject to measurement uncertainty and the effect on the Consolidated Financial Statements of changes in such estimates in future periods could be significant.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Specific amounts and disclosures affected by estimates and assumptions are:

Significant judgments

Determination of cash-generating units ("CGU")

Property and equipment are aggregated into CGUs based on their ability to generate largely independent cash flows and are used for impairment testing. The determination of the Company's CGUs is subject to management's judgment.

Significant estimates and assumptions

Reserves

Oil and gas development and production properties are depleted on a unit of production basis at a rate calculated by reference to proved reserves determined in accordance with the Society of Petroleum Engineers rules and incorporating the estimated future cost of developing and extracting those reserves. Oil and gas reserves are also used to evaluate impairment of PP&E properties. Commercial reserves are determined using estimates of oil and natural gas in place, recovery factors, discount rates and forward future prices. Future development costs are estimated using assumptions as to the number of wells required to produce the commercial reserves, the cost of such wells and associated production facilities, and other capital costs. There are numerous uncertainties inherent in estimating oil and gas reserves. Estimating reserves is very complex, requiring many judgments based on geological, geophysical, engineering and economic data. These estimates may change, having either a positive or negative impact on the statement of comprehensive loss as further information becomes available and as the economic environment changes.

Decommissioning liabilities

The Company estimates the decommissioning obligations for oil and natural gas wells and their associated production facilities and pipelines. In most instances, removal of assets and remediation occurs many years into the future. Amounts recorded for the decommissioning obligations and related accretion expense require estimates regarding removal date, future environmental legislation, the extent of reclamation activities required, the engineering methodology for estimating costs, future removal technologies in determining the removal costs, and discount rates to determine the present value of these cash flows.

Exploration and evaluation ("E&E") assets

The accounting policy for E&E assets is described in note 3. The application of this policy requires management to make certain estimates and assumptions as to future events and circumstances as to whether economic quantities of reserves have been found.

Share-based compensation

The fair value of stock options and warrants granted is recognized using the Black-Scholes option pricing model. Measurement inputs include the Company's share price on the measurement date, the exercise price of the option, the expected volatility of the Company's shares, the expected life of the options, expected dividends and the risk-free rate of return. The Company estimates volatility based on the historical share price in the publicly traded markets. The expected life of the options is based on historical experience and estimates of the holder's behavior. Dividends are not factored in as the Company does not expect to pay dividends in the foreseeable future. Management also makes an estimate of the number of options that will be forfeited and the rate is adjusted to reflect the actual number of options that actually vest.

Recoverability of assets

The Company assesses impairment on its assets that are subject to amortization when it has determined that a potential indicator of impairment exists. Impairment exists when the carrying value of a non-financial asset or CGU exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The Company used the calculation of fair value less costs to sell to determine the fair value of its CGU's. In determining the fair value less costs to sell, the amount is most sensitive to the future commodity prices, discount rates, and estimates of proved and probable reserves, to determine an implied fair value of the CGU being tested.

Provision for doubtful accounts

The provision for doubtful accounts is reviewed by management on a monthly basis. Trade receivables are considered for impairment on a case-by-case basis when they are past due or when objective evidence is received that a customer will default. Management makes these assessments after taking into consideration the customer's payment history, their credit worthiness and the current economic environment in which the customer operates to assess impairment. The Company's historical bad debt expenses have not been significant and are usually limited to specific customer circumstances. However, given the cyclical nature of the oil and natural gas industry along with the current economic operating environment, a customer's ability to fulfill its payment obligations can change suddenly and without notice.

RECENT ACCOUNTING PRONOUNCEMENTS

The following standard has been issued and is effective for annual 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 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.