



# *Emerald Bay Energy*

**EMERALD BAY ENERGY, INC.**

**MANAGEMENT DISCUSSION AND ANALYSIS**

**FOR THE QUARTER ENDED  
JUNE 30, 2006**

**AUGUST 29, 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 June 30, 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		For the six months ended	
	June 30 2006 (\$)	June 30 2005 (\$)	June 30 2006 (\$)	June 30 2005 (\$)
Revenues (before royalties)	564,426	417,076	1,499,947	725,519
Net income (loss)	(367,210)	(322,033)	(613,660)	(656,382)
Net income (loss) per share (basic and diluted)	(0.01)	(0.02)	(0.01)	(0.04)
Cash flow used from operations	(95,757)	(135,053)	25,612	(357,252)
Per share	(0.003)	(0.008)	0.001	(0.008)
Total assets	4,305,218	3,287,243	4,305,218	3,287,243
Secured term debt	-	(7,500)	-	352,500

The Company has recorded a net loss of \$367,210 for the second quarter, compared to a net loss of \$322,033 for the same period in the prior year. The Company has recorded a cash flow deficit of \$95,757 in 2006 compared to a deficit in 2005 of \$135,053.

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

At Twining, the Company is in the process of commencing an extensive seismic program. This process will be a valuable resource to the Company in identifying drilling targets in the Twining area. The Company has recently completed drilling operations at the 10-18 location. The Company has tested the Pekisko and Eilerslie formations and has determined these zones not to be commercially viable. It is anticipated that the Company will complete the Mannville formation in the 10-18 well and begin production in Q3 2006. Additionally, the Company is currently negotiating farm-in opportunities in the area for further exploration this year.

At Edson, the Company is evaluating 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 Q4 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 tie 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 fourth 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		For the six months ended	
	June 30 2006 (\$)	June 30 2005 (\$)	June 30 2006 (\$)	June 30 2005 (\$)
Oil and NGLs	186,617	72,538	434,750	144,591
Per barrel	61.50	46.59	55.73	48.04
Natural gas	429,095	332,459	1,095,385	584,507
Per mcf	6.49	7.89	7.76	7.76
Total gross revenue	615,712	404,997	1,530,135	729,099
Per boe	43.78	47.18	48.83	46.85

## **Sales Volumes**

	For the three months ended		For the six months ended	
	June 30 2006	June 30 2005	June 30 2006	June 30 2005
Crude oil – barrels per day	14	8	13	7
Natural gas – mcf per day	727	463	780	416
NGLs – barrels per day	19	9	30	9
BOE – barrels per day	155	94	173	86

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

### **Royalties**

All of Emerald Bay's royalties are paid to the Crown. During the second quarter, Emerald Bay's royalties of \$176,828 represented 31.3% of revenues, up from \$86,751 and 20.8% of revenues in the same period in the prior year.

### **Production Expense**

Production expenses of \$173,570 in the second quarter were incurred at a rate of \$12.34 per BOE of sales volume, up from \$65,153 and \$7.62 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 \$678,493 in the second quarter were comparable to \$641,154 in the same period in the prior year.

### **Stock Option Expense**

No further stock options were issued in the second quarter.

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

There were no R&D expenses for the period ended June 30, 2006. There were R&D expenses totaling \$72,355 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 accretion**

Depletion, depreciation and accretion ("DD&A") costs of \$271,146 were incurred in the second quarter, up from \$121,482 in the same period in the prior year. This represents an increase to \$19.28 per BOE from \$14.20 per BOE in the second quarter of 2005.

## **LIQUIDITY AND CAPITAL RESOURCES**

In order to support Emerald Bay'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 June 30, 2006, its estimated tax pools were approximately \$4.5 million.

## **SHAREHOLDERS EQUITY**

As at June 30, 2006, there were 27,903,277 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, 7,250,500 common shares may be issued on the exercise of warrants.

## **TRANSACTIONS WITH RELATED PARTIES**

Emerald Bay'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 Bay's ongoing equity issues. As Emerald Bay's 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 Bay's related party transactions.