



*Emerald Bay Energy*

**Emerald Bay Energy Inc.  
Financial Statements  
For the six months ended  
June 30, 2005  
(Prepared by Management - Unaudited)**

	<b>Contents</b>
<b>Note to Shareholders</b>	<b>2</b>
<b>Financial Statements</b>	
<b>Balance Sheets</b>	<b>3</b>
<b>Statements of Operations and Deficit</b>	<b>4</b>
<b>Statements of Cash Flows</b>	<b>5</b>
<b>Notes to Financial Statements</b>	<b>6 - 9</b>

## **UNAUDITED INTERIM FINANCIAL STATEMENTS**

In Accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company Disclosed that its auditors have not reviewed the unaudited financial statements for the period ended June 30, 2005.

**Emerald Bay Energy Inc.**  
**Balance Sheets**  
**Prepared by Management - Unaudited**

	<b>June 30 2005</b>	<b>December 31 2004</b>
		Audited
<b>Assets</b>		
<b>Current</b>		
Cash and short term investments	\$ 48,699	\$ 98,160
Accounts receivable	486,593	480,293
Prepaid expenses and deposits	22,892	55,321
	558,184	633,774
<b>Due from related parties</b>	<b>218,500</b>	<b>202,212</b>
<b>Property and equipment (Note 4)</b>	<b>2,450,852</b>	<b>2,056,461</b>
<b>License</b>	<b>59,707</b>	<b>61,765</b>
	<b>\$ 3,287,243</b>	<b>\$ 2,954,212</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current</b>		
Bank loan	\$ 352,500	\$ 360,000
Accounts payable and accrued liabilities	1,836,190	2,069,007
	2,188,690	2,429,007
<b>Asset retirement obligation</b>	<b>107,662</b>	<b>97,344</b>
	<b>2,296,352</b>	<b>2,526,351</b>
<b>Going concern assumption (Note 2)</b>		
<b>Shareholders' equity</b>		
Share capital (Note 5(b))	3,138,396	1,991,825
Contributed surplus	95,024	22,183
Deficit	(2,242,529)	(1,586,147)
	990,891	427,861
	<b>\$ 3,287,243</b>	<b>\$ 2,954,212</b>

"Shelby D. Beattie" Director  
Shelby D. Beattie

"Leonard D. Rice" Director  
Leonard D. Rice

The accompanying notes are an integral part of these financial statements.

**Emerald Bay Energy Inc.**  
**Statements of Operations and Deficit**  
**Prepared by Management - Unaudited**

	For the three months ended		For the six months ended	
	June 30 2005	June 30 2004	June 30 2005	June 30 2004
<b>Revenue</b>				
Petroleum and natural gas sales	\$ 417,076	\$ 310,702	\$ 725,519	\$ 590,306
Royalties	(86,751)	(20,093)	(157,963)	( 77,335)
Alberta Royalty Tax Credits	-	-	-	4,695
	<u>330,325</u>	<u>290,609</u>	<u>567,556</u>	<u>517,666</u>
<b>Expenses</b>				
Operating	65,153	97,120	127,135	137,149
General and administrative	321,345	373,734	641,154	593,359
Stock based compensation	65,499	-	72,783	-
Research and development	72,355	106,125	140,287	145,246
Depletion, amortization and accretion	121,482	41,132	226,289	73,298
Interest	5,004	-	16,290	90
	<u>650,838</u>	<u>618,111</u>	<u>1,223,938</u>	<u>949,142</u>
<b>Loss from operations</b>	<u>(320,513)</u>	<u>(327,502)</u>	<u>(656,382)</u>	<u>(431,476)</u>
<b>Other income</b>				
Interest	(1,520)	4,704	-	10,384
<b>Loss before income taxes</b>	<u>(322,033)</u>	<u>(322,798)</u>	<u>(656,382)</u>	<u>( 421,192)</u>
<b>Income taxes (recovery)</b>				
Current	-	(112,016)	-	(112,000)
Future	-	-	-	(34,000)
	<u>-</u>	<u>(112,016)</u>	<u>-</u>	<u>(146,000)</u>
<b>Loss for the period</b>	<u>(322,033)</u>	<u>(210,782)</u>	<u>(656,382)</u>	<u>( 275,092)</u>
Deficit, beginning of period	<u>(1,920,496)</u>	<u>(669,349)</u>	<u>(1,586,147)</u>	<u>(605,039)</u>
<b>Deficit, end of period</b>	<u>\$ (2,242,529)</u>	<u>\$ (880,131)</u>	<u>\$ (2,242,529)</u>	<u>\$ (880,131)</u>
<b>Loss per common share basic and diluted(Note 5(d))</b>	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>	<u>\$ (0.04)</u>	<u>\$ (0.02)</u>
<b>Weighted average number of shares</b>	<u>17,463,860</u>	<u>11,708,304</u>	<u>17,463,860</u>	<u>11,708,304</u>

The accompanying notes are an integral part of these financial statements.

**Emerald Bay Energy Inc.**  
**Statements of Cash Flows**  
**Prepared by Management - Unaudited**

	For the three months ended		For the six months ended	
	June 30 2005	June 30 2004	June 30 2005	June 30 2004
<b>Cash flows from operating activities</b>				
Loss for the period	\$ (322,034)	\$ (210,782)	\$ (656,382)	\$ (275,092)
Adjustments for:				
Depletion, amortization and accretion	121,482	41,132	226,289	73,298
Future income taxes	-	(112,000)	-	(146,000)
Stock option expense	65,499	7,306	72,841	7,306
	<u>(135,053)</u>	<u>(274,344)</u>	<u>(357,252)</u>	<u>(340,488)</u>
Changes in non-cash operating balances				
Accounts receivable	(1,253)	(69,964)	(6,300)	(126,590)
Prepaid expenses and deposits	32,429	-	32,429	1,959
Accounts payable and accrued liabilities	(188,957)	367,145	(232,817)	254,761
	<u>(157,781)</u>	<u>297,181</u>	<u>(206,688)</u>	<u>130,130</u>
<b>Cash flows from investing activities</b>				
Purchases of property and equipment	138,126	(316,676)	(608,304)	(507,505)
<b>Cash flows from financing activities</b>				
Bank loan	(37,500)	-	(7,500)	-
Advances (repayments) from related parties	(14,767)	7,604	(16,288)	2,717
Issuance of share capital, net of issue costs	13,125	-	1,146,571	(7,165)
	<u>(39,142)</u>	<u>7,604</u>	<u>1,122,783</u>	<u>(4,448)</u>
<b>Increase (decrease) in cash and equivalents</b>	<b>(193,850)</b>	<b>(286,235)</b>	<b>(49,461)</b>	<b>(722,311)</b>
Cash and equivalents, beginning of period	242,549	528,919	98,160	964,995
<b>Cash and equivalents, end of period</b>	<b>\$ 48,699</b>	<b>\$ 242,684</b>	<b>\$ 48,699</b>	<b>\$ 242,684</b>

The accompanying notes are an integral part of these financial statements.

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**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**  
**Prepared by Management - Unaudited**

**June 30, 2005**

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**1. Nature of Operations**

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Emerald Bay Energy Inc. (the "Company") was incorporated under the Business Corporations Act of Alberta on May 9, 1997 and is listed on the TSX Venture exchange. The Company is engaged in the exploration for and development of petroleum and natural gas properties principally in Alberta and Texas and is developing a lateral drainhole drilling technology.

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**2. Going Concern Assumption**

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The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The Company has a \$1,630,506 working capital deficiency at June 30, 2005, and continues to incur losses. The Company is also in violation of certain financial banking covenants which could result in the lender demanding repayment of the loan. Consequently there is significant doubt about the Company's ability to continue as a going concern.

Management are committed to raising additional capital to meet exploration and operating obligations. While management has been successful in the past in obtaining financing, there is no assurance that sufficient funds will be raised in the future. During the first quarter of 2005 the Company completed a \$560,905 private placement share issuance net of issue costs. During the second quarter of 2005 the Company completed a \$601,625 private placement share issuance net of issue costs. The Company's ability to continue as a going concern is dependent upon the Company's ability to raise additional equity to meet its current working capital shortfall and provide for future operational needs. Future lateral drainhole drilling operations are dependent on successful testing results and access to additional funding.

These financial statements do not give effect to adjustments to the carrying values of assets and liabilities and reported revenue and expenses that would be necessary should the Company be unable to continue as a going concern.

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**3. Summary of Significant Accounting Policies**

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The financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgement with reasonable limits of materiality and within the framework of the significant accounting policies employed in the audited financial statements for the fiscal year ended December 31, 2004.

**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**  
**Prepared by Management - Unaudited**

**June 30, 2005**

**4. Property and Equipment**

	<b>June 30, 2005</b>		
	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>Net Book Value</u>
Petroleum and natural gas properties	\$ 3,399,904	\$ 989,973	\$ 2,409,931
Office furniture and equipment	<u>92,678</u>	<u>51,757</u>	<u>40,921</u>
	<u>\$ 3,492,582</u>	<u>\$ 1,026,307</u>	<u>\$ 2,450,852</u>
	December 31, 2004		
	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>Net Book Value</u>
Petroleum and natural gas properties	\$ 2,795,651	\$ 782,593	\$ 2,013,058
Office furniture and equipment	<u>88,626</u>	<u>45,223</u>	<u>43,403</u>
	<u>\$ 2,884,227</u>	<u>\$ 827,816</u>	<u>\$ 2,056,461</u>

No general administrative expenses have been capitalized to property and equipment.

**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**  
**Prepared by Management - Unaudited**

**June 30, 2005**

**5. Equity Instruments**

- a) Authorized  
 Unlimited number of common voting shares  
 Unlimited number of preferred shares, issuable in series.

- b) Common shares issued and issuable for cash

	Number	Amount
Common shares issued, December 31, 2004	11,708,304	\$ 1,949,425
Private Placement (i)	3,000,000	600,000
Private Placement (ii)	2,755,556	620,000
Share issue costs		(73,429)
Balance June 30, 2005	17,463,860	3,095,996
Warrants outstanding, December 31, 2004	1,108,000	42,400
Warrants issued (i)	3,160,000	-
Warrants issued (ii)	1,377,778	-
Balance June 30, 2005	5,645,778	42,400
<b>Equity instruments balance June 30, 2005</b>		<b>\$ 3,138,396</b>

- (i) On February 18, 2005, the Company completed a private placement of 3,000,000 units at an issued price of \$0.20 per unit, for consideration of \$600,000. Each unit consists of one common share and one share purchase warrant that may be exercised to acquire additional common shares at \$0.25 per share at any time in the two years following the closing of the private placement. All of the common shares issued pursuant to the private placement are subject to a 4 month hold period. 1,757,500 units of the private placement were acquired by directors and officers of the Company. The Company incurred issuance costs of \$39,095 cash and issued 160,000 agent warrants which may be exercised to acquire additional common shares at \$0.25 per share for a one year period.
- (ii) On June 8, 2005, the Company completed a private placement of 2,755,556 units at an issued price of \$0.225 per unit, for consideration of \$620,000. Each unit consists of one common share and one-half of one share purchase warrant that may be exercised to acquire additional common shares at \$0.40 per share at any time in the twelve months following the closing of the private placement. All of the common shares issued pursuant to the private placement are subject to a 4 month hold period. The Company incurred issuance costs of \$18,375 cash.

**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**  
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**June 30, 2005**

**5. Equity Instruments - continued**

c) Stock options

The Company has established a stock option plan whereby the Company may grant directors, officers, employees and consultants up to a maximum of 10% of the issued common shares. The stock options granted on March 29, 2004 vest evenly over a 3 year period from the date of grant and expire 5 years after the date of grant. All other stock options granted vest immediately after the date of grant and expire 5 years after the date of grant.

	<u>June 30, 2005</u>		<u>December 31, 2004</u>	
	<u>Number of options</u>	<u>Weighted average exercise price</u>	<u>Number of options</u>	<u>Weighted Average Exercise price</u>
Stock options, beginning of period	842,904	\$ 0.29	620,000	\$ 0.22
Granted	650,000	0.25	550,000	0.32
Expired	(263,000)	(0.26)	(327,096)	(0.21)
Stock options outstanding, end of period	<u>1,229,904</u>	<u>\$ 0.27</u>	<u>842,904</u>	<u>\$ 0.29</u>
Exercisable, end of year	<u>952,821</u>	<u>\$ 0.26</u>	<u>278,602</u>	<u>\$ 0.23</u>

The stock options outstanding as at June 30, 2005 are as follows:

<u>Exercise prices</u>	<u>Options outstanding</u>			<u>Options exercisable</u>	
	<u>Options outstanding</u>	<u>Weighted average remaining term (years)</u>	<u>Weighted average exercise price</u>	<u>Options exercisable</u>	<u>Weighted average exercise price</u>
\$0.19	104,904	2.5	\$ 0.19	104,904	\$ 0.19
\$0.25	650,000	5.0	0.25	650,000	0.25
\$0.32	475,000	3.8	0.32	197,917	0.32
	<u>1,229,904</u>	<u>4.1</u>	<u>\$ 0.27</u>	<u>952,821</u>	<u>\$ 0.26</u>

d) Diluted loss per share

The exercise of options and warrants would be anti-dilutive.