



Emerald Bay Energy

EMERALD BAY ENERGY, INC.

MANAGEMENT DISCUSSION AND ANALYSIS

**FOR THE QUARTER ENDED
JUNE 30, 2005**

AUGUST 29, 2005

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, 2005, and the audited financial statements for the year ended December 31, 2004.

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

OIL AND GAS OPERATIONS

A successful drilling program was undertaken in the latter half of 2004. The results of that drilling program are partially reflected in the increase in year-end reserves of the company. Further testing of the wells indicates larger reserves than estimated at December 31, 2004, and the company anticipates future increases in production once the wells are tied-in and producing. During 2005 preparatory work to tie in what is expected to be an additional 75 BOE's has taken place. The company anticipates that this production will be tied in by the end of the third quarter 2005.

	For the three months ended		For the six months ended	
	June 30 2005 (\$)	June 30 2004 (\$)	June 30 2005 (\$)	June 30 2004 (\$)
Revenues (before royalties)	417,076	310,702	725,519	590,306
Research and Development costs	(72,355)	(106,125)	(140,287)	(145,246)
Net income (loss)	(322,033)	(210,782)	(656,382)	(275,092)
Net income (loss) per share (basic and diluted)	(0.02)	(0.02)	(0.04)	(0.02)
Total assets	3,287,243	1,965,841	3,287,243	1,965,841
Secured term debt	(7,500)	-	352,500	-

The Company was involved in an extensive exploration program during 2004 that included data collection, geophysical analysis and drilling. Management expects to increase the Company's reserves, production, and cash flow into 2006 as a result of the Company's 2005 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.

In addition, the Company has initiated a review of general and administrative costs and a reorganization of its management group in order to align its organizational structure with its expected future cash flow and activity levels.

Lateral Drainhole Drilling Technology

Historically, Emerald Bay Energy has been engaged in two businesses; exploration, development and production of crude oil, natural gas and natural gas liquids, as well as the development of technology for down-hole drilling applications (the LDD technology). During fiscal 2004 and continuing into 2005, the company achieved successful alpha tests of the technology.

The LDD technology was advanced through the expenditure of significant funds on the development of various components of the tool. This work was supported by a National Research Council IRAP grant of \$145,000, received during 2004. Significant progress has been achieved in critical components as the Company has moved the technology closer to a commercial product.

Management of the Company has determined that it should separate the businesses. In a February 25, 2005 press release, the Company announced plans to transfer the LDD technology to a subsidiary with the intention of creating an independent company with its own management and capital structure. During this restructuring it is anticipated that the Company will significantly reduce support for development of the LDD and the general and administrative expenses associated with the LDD, past June 30, 2005. At the conclusion of this restructuring, Emerald Bay will be a pure Oil and Gas Exploration and Production Company with an interest in the LDD technology.

DETAILED REVIEW OF FINANCIAL RESULTS

Net Earnings and Cash Flow

	For the three months ended		For the six months ended	
	June 30 2005 (\$)	June 30 2004 (\$)	June 30 2005 (\$)	June 30 2004 (\$)
Net earnings (loss)	(322,033)	(210,782)	(656,382)	(275,092)
Per share	(0.02)	(0.02)	(0.04)	(0.02)
Cash flow used from operations	(135,053)	(274,344)	(357,252)	(340,488)
Per share	(0.01)	(0.02)	(0.02)	(0.03)

The Company has recorded a net loss of \$322,033 for the second quarter, compared to a net loss of \$210,782 for the same period in the prior year. The increased loss is mainly due to substantially increased exploration activities which led to a significant increase in depletion, depreciation and amortization costs to support those efforts. In addition the Company recorded a \$65,499 stock option expense to recognize the benefit of the stock options issued in the quarter.

Revenue

	For the three months ended		For the six months ended	
	June 30 2005 (\$)	June 30 2004 (\$)	June 30 2005 (\$)	June 30 2004 (\$)
Oil and NGLs	72,538	64,847	144,591	113,999
Per barrel	46.59	42.89	48.04	39.03
Natural gas	332,459	245,855	584,507	476,307
Per mcf	7.89	7.35	7.76	7.03
Total gross revenue	404,997	310,702	729,099	590,306
Per boe	47.18	43.80	46.85	41.52

Sales Volumes

	For the three months ended		For the six months ended	
	June 30 2005	June 30 2004	June 30 2005	June 30 2004
Crude oil – barrels per day	8	7	7	7
Natural gas – mcf per day	463	368	416	374
NGLs – barrels per day	9	9	9	9
BOE – barrels per day	94	78	86	79

Gross revenue increased for the quarter as compared to 2004 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

All of Emerald Bay's royalties are paid to the Crown. During the second quarter, Emerald Bay's royalties of \$86,751 represented 21.4% of revenues, up from \$20,093 and 6.5% of revenues in the same period in the prior year. Year to date royalties of \$157,963 represented 21.7% of revenues, up from \$77,335 and 13.1% in the same period in the prior year.

Production Expense

Production expenses of \$65,153 in the second quarter were incurred at a rate of \$7.59 per BOE of sales volume, down from \$97,120 and \$13.69 in the same period in the prior year as a result of services performed on certain wells. Year to date production expenses of \$127,135 were incurred at a rate of 8.17 per BOE of sales volume, down from \$137,149 and \$9.65 in the same period in the prior year.

General and administrative ("G&A") expenses

G&A costs of \$321,345 in the second quarter were down 14% from \$373,734 in the same period in the prior year. The decrease is a result of the decreased levels of R&D as the company separates the business units. Year to date G&A costs of \$641,096 were up 8.0% from \$593,359 in the same period in the prior year.

Research and development (“R&D”) expenses

R&D costs of \$72,355 in the second quarter decreased 32% from \$106,125 in 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. Year to date R&D costs of \$140,287 decreased 3% from \$145,246 in the same period in the prior year. Significant progress has been made on the LDD tool during the first half of 2005 as successful Alpha tests of a prototype tool were completed. This milestone is expected to allow the Company to attract direct participation in the tool by investors interested in bringing the tool to a commercial status.

Depletion, depreciation and site restoration expense

Depletion, depreciation and amortization (“DD&A”) costs of \$121,482 were incurred in the second quarter, up from \$41,132 in the same period the in prior year. Year to date DD&A costs of \$226,289 are up from \$73,298 in the same period in the prior year. The significant increase is mainly due to \$1.7 million of oil and gas property additions in the last quarter of 2004 and the first quarter of 2005 which are being amortized over a reserve base as determined from the year end engineering review of the Company’s properties.

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.

TAXES

Emerald Bay is not subject to current income tax. At June 30, 2005, its estimated tax pools were approximately \$3.8 million.

SHAREHOLDERS EQUITY

As at June 30, 2005, there were 17,463,860 common shares issued and outstanding, and an additional maximum total of 952,821 reserved for issuance on the potential exercise of common share purchase options. In addition, 5,645,778 common shares may be issued on the exercise of warrants associated with three private placements in December 2003, February 2005 and June 2005. Details of Emerald Bay’s equity instruments are provided in note 5 to the financial statements.

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 for the fiscal year ended December 31, 2004 fully detail Emerald’s related party transactions.