

## 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 and six months ended June 30, 2015 and the audited annual Consolidated Financial Statements for the year ended December 31, 2014. 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](http://www.sedar.com). The Company is listed on the Canadian Stock Exchange under the symbol "EBY". The MD&A is dated August 31, 2015.

### 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, 2014. 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 June 30, 2015, the Company had not yet achieved profitable operations, had an accumulated a deficit of \$16,788,873 since its inception (December 31, 2014 - \$17,420,929), had negative cash flows from operations of \$731,580 (December 31, 2014 - \$699,315) and had a working capital deficiency of \$4,010,429 (December 31, 2014 - \$5,398,782) (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 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 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 June 30		Six months ended June 30	
	2015	2014	2015	2014
<b>FINANCIAL</b>				
Gross revenue	11,429	28,164	16,066	55,310
Total assets	3,071,753	2,902,399	3,071,753	2,902,399
Cash flows used in operations	451,256	393,783	731,580	483,179
Net comprehensive income (loss)	931,025	(328,251)	647,595	(493,749)
Per share – basic and diluted	0.01	(0.00)	0.00	(0.00)
Capital expenditures	(5,554)	18,141	1,324	20,617
Exploration and evaluation expenditures	67,139	76,852	99,820	150,219
Loan	776,080	1,266,323	776,080	1,266,323
Convertible debt	387,250	149,914	387,250	149,914
<b>OPERATIONS</b>				
<b>Production sales</b>				
Oil (BBLs/d)	-	-	-	-
Natural gas (MCF/d)	34	49	17	58
NGL (BBLs/d)	-	-	-	-
Total (BOE/d @ 6 MCF: 1 BBL)	6	9	3	10
<b>Average pricing</b>				
Natural gas (\$/MCF)	3.37	5.71	3.33	4.67
Oil and NGL's(\$/BBL)	56.03	77.57	54.83	89.07
Combined (\$/BOE)	22.60	36.30	24.15	30.24
<b>Expenses</b>				
Production expense & transportation (\$/BOE)	3.43	29.83	19.71	28.96
Royalty expense (\$/BOE)	1.73	10.45	2.51	5.38
<b>Net Back Combined (\$/BOE)</b>	<b>17.45</b>	<b>(3.98)</b>	<b>1.93</b>	<b>(4.10)</b>

### 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 \$11,429 and \$16,066 for the three and six months ended June 30, 2015 respectively, from revenue of \$28,164 and \$55,310 for the three and six months ended June 30, 2014. During the three and six months ended June 30, 2015, revenue consisted of electricity revenue of \$1,165 and \$4,562, respectively, from the Company's interest in a Power Plant, which began generating saleable electricity during the year ended December 31, 2014. The Company's petroleum and natural gas revenue was nominal during the three and six months ended June 30, 2015 due to the following factors: (i) the Company's current primary focus is on its exploration and evaluation project in Guadalupe County, Texas, where any test revenue generated is netted from capital spending; (ii) in previous years, the Company has disposed of primarily all of its producing oil and natural gas assets; and (iii) substantially all of the Company's remaining oil and natural gas assets continue to be shut-in to preserve existing reserves while the natural gas and oil 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.

Natural gas prices fluctuated to \$3.37/MCF and \$3.33/MCF, respectively, in the three and six months ended June 30, 2015 versus \$5.71/MCF and \$4.67/MCF, respectively, for the three and six months ended June 30, 2014. Oil and NGL combined prices decreased to \$56.03/BOE and \$54.83/BOE, respectively, in the three and six months ended June 30, 2015 from \$77.57/BOE and \$89.07/BOE, respectively, in the three and six months ended June 30, 2014. The average sales price on a BOE basis was \$22.60 and \$24.15, respectively, in the three and six months ended June 30, 2015, compared to \$36.30 and \$30.24, respectively, in the three and six months ended June 30, 2014.

During the three and six months ended June 30, 2015, the average sales volume on a BOE/d basis decreased to 6 BOE/d, and 3 BOE/d, respectively, compared with 9 BOE/d and 10 BOE/d, respectively, during the three and six months ended June 30, 2014.

During the three and six months ended June 30, 2015, cash flows used in operations were \$451,256 and \$731,580, respectively, compared to \$393,783 and \$483,179, respectively, during the three and six months ended June 30, 2014. The increase is primarily due to a lower net income and working capital fluctuations.

## OPERATING RESULTS

Sales – Six months ended	Average Daily Volumes		Average Prices	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Natural Gas (mcf)	17	58	3.33	4.67
Oil (bbls)	-	-	57.72	89.03
NGL (bbls)	-	-	8.75	92.00
<b>Barrels of Oil Equivalent (boe)</b>	<b>3</b>	<b>10</b>	<b>24.15</b>	<b>30.24</b>

During the period ended June 30, 2015, the Company continued to focus its resources toward its exploration program in Guadalupe County, Texas. During the six months ended June 30, 2015, the Company generated \$6,617 in test oil from a development well within Guadalupe, which it sold to third parties, and associated costs to generate the test oil was (\$1,310). The production generated is necessary to the completion of the assets and in order to enter into full production. Accordingly the pre-production revenue and costs have been offset against the exploration and evaluation costs incurred instead of being recognized within the consolidated statement of comprehensive income (loss).

For the six months ended June 30, 2015 natural gas sales decreased to 17 MCF/d compared to 58 MCF/d during the same period in 2014 as 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 decreased during the six months ended June 30, 2015 to \$3.33/MCF versus \$4.67/MCF during the same period in 2014.

Oil and NGL production for the six months ended June 30, 2015 was negligible remaining consistent with the period ended June 30, 2014, and is 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 six months ended June 30, 2015 the average price received for oil was \$57.72/barrel versus \$89.03/barrel during the six months ended June 30, 2014.

During the six months ended June 30, 2015, the average sales volume on a BOE/d basis decreased to 3 BOE/d compared with 10 BOE/d for the six months ended June 30, 2014.

The average sales price on a BOE basis was \$24.15/BOE during the six months ended June 30, 2015, decreasing from \$30.24/BOE received in the six months ended June 30, 2014.

On a barrel of oil equivalent basis, during the six months ended June 30, 2015 and 2014 natural gas accounted for substantially all the 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.

Six months ended June 30,	2015 (\$)	2014 (\$)
Petroleum and natural gas revenue	16,066	55,310
Royalties, petroleum and natural gas	(1,434)	(9,836)
Production expenses, petroleum and natural gas	(21,039)	(52,968)
Operating netback, petroleum and natural gas	(6,407)	(7,494)
Net income (loss)	632,056	(490,019)
Net income (loss) per share (basic and diluted)	0.00	(0.00)
Revenue per BOE	24.15	30.24
Royalty per BOE	2.51	5.38
Operating costs per BOE	19.71	28.96
Operating netback per BOE	1.93	(4.10)

Petroleum and natural gas revenue decreased to \$16,066 for the six months ended June 30, 2015 from revenue of \$55,310 during the six months ended June 30, 2014. Revenue on a BOE basis decreased to \$24.15/BOE from \$30.24/BOE during the six months ended June 30, 2014.

Royalties decreased to \$1,434 during the six months ended June 30, 2015 compared to the same period in 2014 of \$9,836. Royalty per BOE for the six months ended June 30, 2015 averaged \$2.51/BOE, which was a decrease from \$5.38/BOE during the six months ended June 30, 2014.

Production expenses in the six months ended June 30, 2015 decreased to \$21,039 from the six months ended June 30, 2014 of \$52,968. Operating costs per BOE for the six months ended June 30, 2015 decreased to \$19.71/BOE from \$28.96/BOE in the six months ended June 30, 2014.

Operating netback from petroleum and natural gas sales increased to (\$6,407) during the six months ended June 30, 2015 from (\$7,494) during the six months ended June 30, 2014. Operating netback per BOE increased to \$1.93/BOE from (\$4.10)/BOE.

The Company's revenue decrease was due to certain Canadian assets continuing to be shut-in to preserve existing reserves while the natural gas prices remain low and the reduction in oil prices since June 30, 2014.

### Royalties per unit of Production

Six months ended	June 30, 2015	June 30, 2014
Gas (\$/mcf)	0.41	0.78
Oil (\$/bbl)	2.85	20.97
NGL (\$/bbl)	-	-
<b>Total (\$/boe)</b>	<b>2.51</b>	<b>5.38</b>

The royalties per MCF for natural gas decreased to \$0.41/MCF from \$0.78/MCF in 2014. Oil royalties decreased to \$2.85/BBL from \$20.97/BBL in 2014. Combined royalties for all products decreased to \$2.51/BOE in 2015 from \$5.38/BOE the previous period.

## GENERAL & ADMINISTRATIVE EXPENSES

After recoveries, general and administrative expenses (“G&A”) decreased to \$168,813 and \$232,971, respectively, during the three and six months ended June 30, 2015 from \$232,971 and \$362,297, respectively, for the same period during 2014. 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.

	General & Administrative Expenses			
	Three months ended June 30		Six months ended June 30	
	2015 (\$)	2014 (\$)	2015 (\$)	2014 (\$)
Net G&A expense	168,813	232,971	328,906	362,297

## STOCK BASED COMPENSATION

During the three and six months ended June 30, 2015, the Company recognized share-based payment expense of \$nil, in the statement of comprehensive income (loss) (June 30, 2014 - \$2,086 and \$7,016, respectively).

## 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 \$510,604 as at December 31, 2014 to \$527,450 as at June 30, 2015. During the year ended December 31, 2014, the Orphan Well Society abandoned and reclaimed certain wells owned by the Company. The costs incurred by the Orphan Well Society of \$92,767 to abandon and reclaim the wells were recorded as a gain in the Company’s statement of loss and comprehensive loss for the year ended December 31, 2014.

## 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.

	Depletion and Depreciation			
	Three months ended June 30		Six months ended June 30	
	2015 (\$)	2014 (\$)	2015 (\$)	2014 (\$)
Depletion and depreciation	4,698	16,272	9,630	38,134

During the three and six months ended June 30, 2015, depletion and depreciation expenses were \$4,698 and \$9,630, respectively, compared to \$16,272 and \$38,134 during the same period in 2014. The year to date decrease was primarily due to the continued reduction in production during the current year.

## CASH FLOWS FROM OPERATIONS

During the three and six months ended June 30, 2015, cash flows used in operations were \$451,256 and \$731,580, respectively, compared to \$393,783 and \$483,179 during the same period in 2014. Funds used in operations during the three and six months ended June 30, 2015 were \$273,588 and \$535,360, respectively, from the previous year’s \$231,425 and \$449,904. The year to date increase in cash flows used in operations and funds used in operations was primarily due to the reduction net income, significantly lower petroleum and natural gas revenue, and for cash flows used in operations, working capital fluctuations.

## CAPITAL EXPENDITURES

	Six months ended June 30,	
	2015 (\$)	2014 (\$)
Exploration and evaluation expenditure	99,820	150,219
Capital expenditures	1,324	20,617

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.

During the six months ended June 30, 2015, the Company generated \$6,617 in test oil from a development well within Guadalupe, which it sold to third parties, and associated costs to generate the test oil was (\$1,310). The production generated is necessary to the completion of the assets and in order to enter into full production. Accordingly the pre-production revenue and costs have been offset against the exploration and evaluation costs incurred instead of being recognized within the consolidated statement of comprehensive income (loss).

The Company's expenditures on the Electric Generation Pilot Project (the "Project") were minimal during the quarter. During the year ended December 31, 2014, the Company entered into an agreement (the "Agreement") to develop, own and operate a natural gas fired electrical power generation plant (the "Power Plant"). Pursuant to the Agreement, the existing partners of certain wells agreed to contract all of their working interest shares of gas production from these wells as fuel for the Power Plant. Capital expenditures on petroleum and natural gas property and equipment remain minimal and reflect the low natural gas prices, which continue to delay certain projects in Canada until there is a rebound in the commodity price.

## EQUITY INVESTMENT IN PRI

On June 29, 2015, the Company disposed 60% of its ownership in Production Resources Inc. ("PRI") to a party with an existing shareholding in PRI. The Company was holding the investment in PRI at a cost of \$148,434 and received proceeds of \$1,291,500, and accordingly recorded a gain on the disposition of \$1,143,066. The disposition reduced the Company's interest in the share capital of PRI from 25% to 10%.

The investment in PRI as at June 30, 2015 is as follows:

	CDN \$
<b>Net investment, December 31, 2013</b>	\$332,678
Proportionate share of loss for the period	(34,934)
<b>Net investment, December 31, 2014</b>	\$297,744
Proportionate share of loss for the period up to the disposition	(50,354)
Disposition of ownership in the share capital	(148,434)
<b>Net investment, June 30, 2015</b>	<b>\$98,956</b>



## 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)	June 30 2015	Mar 31 2015	Dec 31 2014	Sept 30 2014	June 30 2014	Mar 31 2014	Dec 31 2013	Sept 30 2013
Petroleum and natural gas sales	11	5	17	2	28	27	28	63
Net income (loss)	891	(259)	(596)	(346)	(335)	(155)	(1,306)	(258)
Net income (loss) per share Basic and diluted	0.01	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.01)	(0.00)
<b>Average daily sales</b>								
Natural gas (MCF/d)	34	(1)	25	-	49	68	56	26
Oil/NGL (BBLs/d)	-	-	1	-	-	1	2	6
Barrels of oil equivalent (BOE/d)	6	-	5	-	9	12	11	10
<b>Average sales prices</b>								
Natural Gas (\$/MCF)	3.37	(4.52)	3.47	-	5.71	3.92	2.99	2.80
Oil/NGL (\$/BBL)	56.03	53.42	75.17	108.67	77.57	103.27	90.71	99.24
Sales price of oil equivalent (\$/BOE)	22.60	79.15	31.44	-	30.24	25.77	28.23	65.49
Operating costs (\$/BOE)	3.43	597.19	115.03	-	29.83	28.32	43.95	50.72
Royalty Expense (\$/BOE)	1.73	30.19	16.78	-	10.45	1.64	3.36	3.42
Operating netback (\$/BOE)	17.45	(548.23)	(100.38)	-	(3.98)	(4.19)	(19.08)	11.35

### 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. Since September 30, 2013, petroleum and natural gas sales have further declined due to the disposal of the remaining producing assets in the Somerset and Taylor-Ina counties during the fourth quarter of 2013.

Net comprehensive income (loss) increased during the fourth quarter for both the year ended December 31, 2014 and December 31, 2013, primarily due to the impairment of property and equipment taken during both years. During the fourth quarter of 2014, the net loss decreased in comparison to the fourth quarter of 2013 primarily due to the gain on abandonment and reclamation of \$157,767 during 2014 combined with higher G&A costs and share based payments incurred during the fourth quarter of 2013.

The impairments have all been recognized in the fourth quarter.

The Company recorded net income of \$891,114 during the three months ended June 30, 2015 due to the gain recognized on the disposition of a portion of its interest in the share capital of PRI.

## LIQUIDITY & CAPITAL RESOURCES

In order to resolve its working capital deficiency of \$4,010,429, 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 with a maturity date of August 15, 2013, which was later extended until August 15, 2014, with the same terms and conditions (the "Loan"). Interest on the Loan is 10% per annum, payable monthly, on the outstanding principal amount.

Pursuant to the Loan agreement, the Company issued to the Lender 5,000,000 share purchase warrants (the "Warrants"). Each Warrant was 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. On April 9, 2014, the Warrants received regulatory approval and accordingly were valued as of this date at \$40,241. On August 15, 2014, the Warrants expired unexercised.

On October 2, 2014, the Company received approval to extend the maturity date of the New Loan until August 15, 2015, with a 10% interest rate that compounds monthly (the "Extension"). Pursuant to the Extension, no warrants were offered, however a conversion feature enabling the Lender to convert any or all of the outstanding Extension into common shares of the Company at a conversion price of \$0.05 per common share at any time prior to the August 15, 2015, subject to regulatory approval. All other terms and conditions of the Extension remain unchanged. On April 17, 2015, the conversion feature on the Extension received regulatory approval. On June 29, 2014, the Company used part of the proceeds received from the disposition of a portion of its interest in PRI to repay \$500,000 to the Lender.

On June 29, 2015, the maturity date of the Loan was renewed until August 15, 2017 under the same terms and conditions. The conversion feature on the Extension expired on August 15, 2015, but was replaced with a new conversion feature on the renewal to August 15, 2017. However, the new conversion feature has not yet received regulatory approval.

The Company may, at any time, repay the Extension in full without notice or penalty. If the Company is in default of the requirements included in the Extension agreement or the Lender believes the Company's ability to repay the loan is impaired, the Lender may demand repayment of the Extension or accelerate the date for payment. During the six months ended June 30, 2015, the Company incurred interest of \$78,298 (June 30, 2014 - \$63,333).

During the year ended December 31, 2014, the Lender advanced an additional \$100,000 to the Company under the same terms as the New Loan. However, the additional advance was not included in the conversion feature.

Security for the New Loan consists of a \$1,200,000 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, 2014 and March 26, 2015, it was mutually agreed upon between the Lender and the Company to extend the loan under the same terms for an additional year to December 31, 2014 and December 31, 2015, respectively. Interest on the loan is 12% per annum, payable monthly, on the outstanding principal amount monthly. During the six months ended June 30, 2015, the Company incurred interest of \$15,380 (June 30, 2015 - \$13,288).

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 at a price of \$0.05 per common share, and accordingly. All other terms and conditions remain the same. At December 31, 2014, the loan had matured and the derivative liability that was recognized was removed and recorded as a gain on the derecognition of the derivative financial liability in the consolidated statement of comprehensive income (loss) as finance expense. As at June 30, 2015, the conversion feature on the March 26, 2015 extension had not yet received regulatory approval and accordingly no value has been assigned to this feature. All other terms and conditions of the extension remain unchanged.

On March 26, 2015, the Lender advanced an additional loan amount of \$75,000 CDN (December 31, 2014 – additional amount of \$100,000 USD) to the Company under the same terms as the Loan Agreement. However, the additional advances were not included in the conversion feature. The modifications did not result in an extinguishment of the old convertible debt instrument and recognition of a new convertible debt instrument. The proceeds of the loan were used to continue the Company's exploration program in Texas.

## 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>August 31, 2015</u>	<u>June 30, 2015</u>
Common Shares	158,610,189	158,610,189
Warrants (i)	14,938,500	17,938,500
Stock Options (ii)	11,625,000	11,625,000

Notes:

- i) 14,938,500 of the warrants entitle the holder to acquire one additional common share for \$0.05 per share until August 22, 2016.
- ii) 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:

	June 30, 2015	December 31, 2014
	\$	\$
Note receivable from officer	<u>247,970</u>	247,970
Less current portion	<u>(50,000)</u>	(50,000)
	<u>197,970</u>	197,970

During the year ended December 31, 1999, a promissory note was issued to an officer of the Company bearing interest at 3% per annum with 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. During the year ended December 31, 2014, the Company revised the terms of the loan (the "Revised Promissory Note"), including fixed repayment terms and removing the term securing the note with 393,000 common shares of the Company. Historically the aggregate decline in the fair value of these common shares since the inception of the promissory note would offset the amount payable. Under the Revised Promissory Note, a balance of \$247,970, including the principal of \$218,500 and accrued interest, is payable by the officer to the Company. The payments will commence December 31, 2015, and will be paid annually in \$50,000 tranches until December 31, 2018, with the final payment of \$47,970 due on December 31, 2019. Interest is calculated at 1% per annum, and is payable annually commencing December 31, 2015, concurrently with each principal payment. The officer may repay the principal amount in whole or in part at any time. The reversal of the fair value allowance of \$237,511 was included in the statement of comprehensive income (loss).

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

For the three months ended June 30, 2015:

(i) Aggregate fees of \$8,616 (June 30, 2014 - \$8,616) were charged by corporations, which are owned and controlled by other equity investors in PRI, and were all recorded as general and administrative costs.

For the six months ended June 30, 2015:

(ii) Aggregate fees of \$17,232 (June 30, 2014 - \$17,233) were charged by corporations, which are owned and controlled by other equity investors in PRI, and were all recorded as general and administrative costs.

(iii) Included in accounts payable at June 30, 2015 was \$120,646 owing to officers of the Company (December 31, 2014 - \$104,611).

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 March 5, 2014, 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 November 30, 2016.
- b) The Company has entered into various vehicle loan agreements and as at June 30, 2015, total principal repayments of \$4,095 remain, all of which will be paid in the year ending December 31, 2015.
- 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 \$333,551 at June 30, 2015 (December 31, 2014 - \$333,551). The Company has also estimated a potential liability for penalties and taxes on the amounts of \$107,500 (December 31, 2014 - \$107,500) 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.
- d) During the six months ended June 30, 2015, the Company reached a final settlement with an unrelated corporation (the "Drilling Corporation") relating to events that occurred during 2008 whereby the Drilling Corporation agreed to provide a rig to drill a well in which the Company was the operator of, and held a 15.94% interest in. Due to several timing and maintenance delays on the part of the Drilling Corporation, the Company and the partners in the well did not pay the full amount of the final invoice, which the Company believed the Drilling Corporation had accepted. During 2010, the Drilling Corporation filed a statement of claim for the remaining balance of the final invoice. During the six months ended June 30, 2015, the Company opted to settle with the Drilling Corporation for an amount of \$145,512. The amount is payable by the Company and its partners in monthly installments of \$4,300, including interest and principal, until June 2018. The Company is paying the installments on behalf of the partners and has recorded a net liability for its portion \$23,195.

## **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 RISK MANAGEMENT

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, the bank loan, current portion of long-term debt and long-term debt.

<b>Financial Instrument</b>	<b>Classification</b>	<b>Carrying Value</b>	<b>Fair Value</b>
		<b>\$</b>	<b>\$</b>
Cash and cash equivalents	Fair value through profit and loss	162,930	162,930
Short-term investments	Fair value through profit and loss	63,713	63,713
Trade and other receivables	Loans and receivables	373,605	373,605
Due from related parties	Loans and receivables	247,970	247,970
Accounts payable and accrued liabilities	Other financial liabilities	3,989,728	3,989,728
Shareholder indemnity	Other financial liabilities	333,551	333,551
Loan	Other financial liabilities	776,080	776,080
Convertible debt	Other financial liabilities	387,250	387,250
Bank loan	Other financial liabilities	29,868	29,868
Current portion of long-term debt	Other financial liabilities	3,255	3,255

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 June 30, 2015, 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 June 30, 2015, the Company's trade and other receivables have been aged as follows:

<b>Days outstanding</b>	<b>June 30, 2015</b>	December 31, 2014
	\$	\$
0-30 days	<b>73,897</b>	59,609
31-60 days	<b>2,724</b>	32,816
61-90 days	-	36,418
Greater than 90 days	<b>296,984</b>	113,081
Total	<b>373,605</b>	241,924

Amounts outstanding for more than 90 days are considered past due. During the year ended December 31, 2014, the Company wrote off \$43,064 of trade and other receivables. The Company deems all amounts remaining in trade and other receivables as collectible and as such, a provision for doubtful accounts has not been recorded at June 30, 2015 (June 30, 2014 - \$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 June 30, 2015, the Company's maximum exposure to liquidity risk is the total current liabilities of \$4,727,866 (December 31, 2014 - \$5,955,469).

The current liabilities and commitments are due as follows:

Accounts payable and accrued liabilities	3,989,728	Due within 90 days
Convertible debt (note 11)	387,250	Maturity date of December 31, 2015
Current portion of bank loan (note 9)	14,082	Due within 12 months
Current portion of long-term debt (note 14(b))	3,255	Due within 12 months
Shareholder indemnities (note 14(c))	333,551	Due on demand

The Company has entered into lease agreements on office premises for its various locations. Future minimum annual lease payments under the lease agreement are as follows:

2016                      \$33,247

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.

The Company had no commodity call options outstanding as at June 30, 2015.

(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 June 30, 2015, 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 \$13,400 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 June 30, 2015, all of the Company's debt, including the loan, the convertible debt and the bank loan, 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 period ended June 30, 2015.

(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. Additionally, the Company has completed the electric generation project in Nevis, Alberta. This pilot project paves the way for the Company to explore electric generation at other areas in Alberta in order to create new revenue streams. 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 developed property and equipment ("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 income (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 will be 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 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 CGUs. 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 Company has reviewed the new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Company. The Company has not quantified the effect of the following:

IFRS 15 – “Revenue from Contracts with Customers”, replaces International Accounting Standard 11, “Construction Contracts” (“IAS 11”), IAS 18, “Revenue” (“IAS 18”), and several revenue-related interpretations. IFRS 15 establishes a single revenue recognition framework that applies to contracts with customers. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. Disclosure requirements have also been expanded. This IFRS becomes effective for annual periods beginning on or after January 1, 2017 with earlier adoption permitted. The standard may be applied retrospectively or using a modified retrospective approach. The Company is currently evaluating the impact of adopting IFRS 15 on the 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. This IFRS becomes effective for 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 financial statements.