



Emerald Bay Energy

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

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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 September 30, 2005

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

	September 30	December 31
	2005	2004
		Audited
Assets		
Current		
Cash and short term investments	\$ 437,782	\$ 98,160
Accounts receivable	660,644	480,293
Alberta royalty tax receivable	30,363	-
Prepaid expenses and deposits	19,799	55,321
	1,148,588	633,774
Due from related parties	220,143	202,212
Property and equipment (Note 4)	2,271,487	2,056,461
License	58,678	61,765
	\$ 3,698,896	\$ 2,954,212
<hr/>		
Liabilities and Shareholders' Equity		
Current		
Bank loan	\$ -	\$ 360,000
Accounts payable and accrued liabilities	1,053,441	2,069,007
	1,053,441	2,429,007
Demand loan (Note 6)	1,670,000	-
Asset retirement obligation	112,821	97,344
	2,836,262	2,526,351
Going concern assumption (Note 2)		
Shareholders' equity		
Share capital (Note 5(b))	3,136,296	1,991,825
Contributed surplus	101,487	22,183
Deficit	(2,375,149)	(1,586,147)
	862,634	427,861
	\$ 3,698,896	\$ 2,954,212

"Shelby D. Beattie" Director
Shelby D. Beattie

"Gibson C. Scott" Director
Gibson C. Scott

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 nine months ended	
	Sept 30 2005	Sept 30 2004	Sept 30 2005	Sept 30 2004
Revenue				
Petroleum and natural gas sales	\$ 392,840	\$ 297,280	\$ 1,118,359	\$ 887,586
Royalties	(93,205)	(61,555)	(251,168)	(138,889)
Alberta Royalty Tax Credits	30,363	-	30,363	4,695
	<u>329,998</u>	<u>235,725</u>	<u>897,554</u>	<u>753,392</u>
Expenses				
Operating	58,566	102,475	185,701	239,624
General and administrative	259,866	212,563	901,021	798,618
Stock option expense	6,463	7,387	79,246	14,693
Research and development	37,423	108,521	177,710	253,768
Depletion, amortization and accretion	96,162	43,243	322,451	116,542
Interest	5,932	800	22,222	889
	<u>464,412</u>	<u>474,989</u>	<u>1,688,351</u>	<u>1,424,134</u>
Income (loss) from operations	<u>(134,414)</u>	<u>(238,264)</u>	<u>(790,797)</u>	<u>(670,742)</u>
Other income				
Interest	1,795	(1,392)	1,795	8,993
Income (loss) before income taxes	<u>(132,619)</u>	<u>(240,656)</u>	<u>(789,002)</u>	<u>(661,749)</u>
Income taxes (recovery) (Note 9)				
Current	-	-	-	-
Future	-	-	-	(146,000)
	<u>-</u>	<u>-</u>	<u>-</u>	<u>(146,000)</u>
Net loss for the period	<u>(132,619)</u>	<u>(240,656)</u>	<u>(789,002)</u>	<u>(515,749)</u>
Deficit, beginning of period	<u>(2,242,530)</u>	<u>(880,132)</u>	<u>(1,586,147)</u>	<u>(605,039)</u>
Deficit, end of period	<u>\$ (2,375,149)</u>	<u>\$ (1,120,788)</u>	<u>\$ (2,375,149)</u>	<u>\$ (1,120,788)</u>
Loss per common share basic and diluted (Note 5(d))	<u>\$ (0.01)</u>	<u>\$ (0.02)</u>	<u>\$ (0.05)</u>	<u>\$ (0.04)</u>
Weighted average number of shares	<u>17,463,860</u>	<u>11,708,304</u>	<u>15,320,514</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 nine months ended	
	Sept 30 2005	Sept 30 2004	Sept 30 2005	Sept 30 2004
Cash flows from operating activities				
Net income (loss) for the period	\$ (132,619)	\$ (240,656)	\$ (789,002)	\$ (515,749)
Adjustments for:				
Depletion, amortization and accretion	96,161	43,243	322,451	116,542
Future income taxes	-	-	-	(146,000)
Stock option expense	-	7,387	72,841	14,693
Cash flow from operations	(36,458)	(190,026)	(393,710)	(530,514)
Changes in non-cash operating balances				
Accounts receivable	(204,414)	98,692	(210,714)	(27,915)
Prepaid expenses and deposits	3,093	-	35,522	1,959
Accounts payable and accrued liabilities	(782,749)	(284,959)	(1,015,566)	(30,197)
	<u>(984,070)</u>	<u>(186,267)</u>	<u>(1,190,758)</u>	<u>(56,153)</u>
Cash flows from investing activities				
Purchases of property and equipment	89,391	(57,433)	(518,913)	(564,938)
Cash flows from financing activities				
Bank loan repayments	(352,500)	205,297	(360,000)	205,297
Advances from financing	1,670,000	-	1,670,000	-
Repayments from related parties	(1,643)	121	(17,931)	2,854
Issuance of share capital, net of issue costs	4,363	(500)	1,150,934	(7,665)
	<u>1,320,220</u>	<u>204,918</u>	<u>2,443,003</u>	<u>200,486</u>
Increase (decrease) in cash and equivalents	389,083	(228,808)	339,622	(951,119)
Cash and equivalents, beginning of period	48,699	242,684	98,160	964,995
Cash and equivalents, end of period	\$ 437,782	\$ 13,876	\$ 437,782	\$ 13,876

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

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

September 30, 2005

1. Nature of Operations

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.

2. Going Concern Assumption

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 \$1,574,853 working capital deficiency at September 30, 2005, and continues to incur losses. 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.

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.

3. Summary of Significant Accounting Policies

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

September 30, 2005

4. Property and Equipment

September 30, 2005

	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>Net Book Value</u>
Petroleum and natural gas properties	\$ 3,310,512	\$ 1,076,637	\$ 2,233,875
Office furniture and equipment	<u>92,678</u>	<u>55,066</u>	<u>37,612</u>
	<u>\$ 3,403,190</u>	<u>\$ 1,131,703</u>	<u>\$ 2,271,487</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

September 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			(75,529)
Balance September 30, 2005	<u>17,463,860</u>		<u>3,093,896</u>
Warrants outstanding, December 31, 2004	1,593,798		42,400
Warrants issued (i)	3,160,000		-
Warrants issued (ii)	1,377,778		-
Balance September 30, 2005	<u>6,131,576</u>		<u>42,400</u>
Equity instruments balance September 30, 2005		\$	<u>3,136,296</u>

- (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
Prepared by Management - Unaudited

September 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.

	September 30, 2005		December 31, 2004	
	Number of options	Weighted average exercise price	Number of options	Weighted Average Exercise price
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	1,229,904	\$ 0.27	842,904	\$ 0.29
Exercisable, end of year	1,031,987	\$ 0.26	278,602	\$ 0.23

The stock options outstanding as at September 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	2.3	\$ 0.19	104,904	\$ 0.19
\$0.25	650,000	4.8	0.25	650,000	0.25
\$0.32	475,000	3.5	0.32	197,917	0.32
	1,229,904	4.1	\$ 0.27	952,821	\$ 0.26

d) Diluted loss per share

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

6. Demand Loan

On September 15, 2005 Emerald Bay entered into an agreement with Toscana Capital Corporation and its financial partner Toscana GP Capital Inc. and obtained a \$2,000,000 bridge financing credit facility used to repay all credit facilities at the Alberta Treasury Branches and provide working capital. The loan bears interest at the rate of 12% per annum. The facility is to be repaid by December 31, 2005 and is secured against the assets of the Corporation. Fees totaling \$40,000 were paid in relation to this financing.