



*Emerald Bay Energy*

## Presidents Message

Emerald Bay Energy presents its report to shareholders for the third quarter ended September 30, 2005.

Emerald Bay is a Calgary based emerging oil and natural gas company engaged in the exploration, development and exploitation of oil and natural gas reserves in Western Canada.

Operational highlights in the third quarter of 2005 included:

- Corporate re-structuring that now allows Emerald Bay to be viewed as a true exploration and production company.
- Bridge financing to complete and tie-in the wells drilled with the 2004 Flow-through funds.

September 15<sup>th</sup> the Company secured \$2 million in bridge financing to fund its completion and tie-in program. With the funding and services in place, the Company was able to make significant strides subsequent to quarter-end. The bridge facility is to be repaid by December 31, 2005, with the option to extend if needed. The Company is optimistic the bridge will be retired with conventional financing by year-end.

We are emphasizing growth through internally generated prospects; however we continue to look for strategic acquisitions of companies or properties which would compliment existing operations or be the genesis of new core areas. Oil and gas prices continue to be strong even with the recent pullback in the prices of oil and gas. We expect high gas prices to continue given the supply disruptions in the Gulf Coast and the coming winter heating season which will increase demand.

Emerald Bay's fourth quarter completion program has gained significant momentum through October and into November. The Company is currently planning to exit 2005 with production in excess of 240 boe per day.

In 2006, with the Company's stronger financial position through cash flow and an equity financing, we look forward to reporting on what we believe will be the Company's most successful year in its history.

Emerald Bay thanks its shareholders for their continued support, and looks forward to future growth and success.

Shelby D. Beattie  
President & CEO  
November 29, 2005



# *Emerald Bay Energy*

**EMERALD BAY ENERGY, INC.**

**MANAGEMENT DISCUSSION AND ANALYSIS**

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

**NOVEMBER 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 September 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 assumptions that may cause actual results to differ materially from those implied herein, and therefore are expressly qualified in their entirety by this cautionary statement.*

### OVERVIEW

### OIL AND GAS OPERATIONS

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 75-150 BOE has taken place. The company anticipates that this production will be tied in during the fourth quarter 2005.

	For the three months ended		For the nine months ended	
	Sept. 30 2005 (\$)	Sept. 30 2004 (\$)	Sept. 30 2005 (\$)	Sept. 30 2004 (\$)
Revenues (before royalties)	392,840	297,280	1,118,359	887,586
Research and Development costs	(37,423)	(108,521)	(177,710)	(253,768)
Net income (loss)	(132,619)	(240,656)	(789,002)	(515,749)
Net income (loss) per share (basic and diluted)	(0.01)	(0.02)	(0.05)	(0.04)
Total assets	3,698,896	1,655,045	3,698,896	1,655,045
Secured term debt	1,670,000	(205,297)	1,670,000	(205,297)

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. 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 completed 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). 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, Reach Energy Innovations, with its own management and capital structure. This transition was completed during the third quarter and the Company will no longer financially support development of the LDD and the general and administrative expenses associated. As a result of the restructuring Emerald Bay is now 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 nine months ended	
	Sept. 30 2005 (\$)	Sept. 30 2004 (\$)	Sept. 30 2005 (\$)	Sept. 30 2004 (\$)
Net earnings (loss)	(132,619)	(240,656)	(789,002)	(515,749)
Per share	(0.01)	(0.02)	(0.05)	(0.04)
Cash flow used from operations	(36,458)	(190,026)	(393,710)	(530,514)
Per share	(0.002)	(0.02)	(0.03)	(0.05)

The Company has recorded a net loss of \$132,619 for the third quarter, compared to a net loss of \$240,656 for the same period in the prior year. The decreased loss is mainly due to increased revenues and reduced operating and research and development expenses.

### ***Revenue***

	For the three months ended		For the nine months ended	
	Sept. 30 2005 (\$)	Sept. 30 2004 (\$)	Sept. 30 2005 (\$)	Sept. 30 2004 (\$)
Oil and NGLs	42,917	62,456	187,508	176,455
Per barrel	56.29	43.71	49.70	40.56
Natural gas	333,174	234,824	917,681	711,131
Per mcf	9.02	6.90	8.18	6.99
Total gross revenue	376,091	297,280	1,105,189	887,586
Per boe	54.35	41.85	49.16	41.63

## **Sales Volumes**

	<b>For the three months ended</b>		<b>For the nine months ended</b>	
	<b>Sept. 30 2005</b>	<b>Sept. 30 2004</b>	<b>Sept. 30 2005</b>	<b>Sept. 30 2004</b>
Crude oil – barrels per day	1	5	5	6
Natural gas – mcf per day	402	370	411	373
NGLs – barrels per day	7	10	9	10
BOE – barrels per day	76	77	83	78

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 third quarter, Emerald Bay's royalties of \$93,205 represented 23.7% of revenues, up from \$61,555 and 20.7% of revenues in the same period in the prior year. Year to date royalties of \$251,168 represented 22.4% of revenues, up from \$138,889 and 15.7% in the same period in the prior year.

## **Production Expense**

Production expenses of \$58,566 in the third quarter were incurred at a rate of \$8.46 per BOE of sales volume, down from \$102,475 and \$14.43 in the same period in the prior year as a result of services performed on certain wells. Year to date production expenses of \$185,701 were incurred at a rate of \$8.25 per BOE of sales volume, down from \$239,624 and \$11.23 in the same period in the prior year.

## **General and administrative (“G&A”) expenses**

G&A costs of \$259,866 in the third quarter were up 22% from \$212,563 in the same period in the prior year. Year to date G&A costs of \$901,021 were up 13% from \$798,618 in the same period in the prior year.

## **Research and development (“R&D”) expenses**

R&D costs of \$37,423 in the third quarter decreased 65% from \$108,521 in the same period in the prior year. The decrease is a result of completing the transition by the company to separate the LDD technology into a subsidiary. Year to date R&D costs of \$177,710 decreased 30% from \$253,768 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's subsidiary, Reach Energy Innovations, 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 \$96,162 were incurred in the third quarter, up from \$43,243 in the same period in the prior year. Year to date DD&A costs of

\$322,451 are up from \$116,542 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 September 30, 2005, its estimated tax pools were approximately \$3.7 million.

## **SHAREHOLDERS EQUITY**

As at September 30, 2005, there were 17,463,860 common shares issued and outstanding, and an additional maximum total of 1,031,987 reserved for issuance on the potential exercise of common share purchase options. In addition, 6,131,576 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.