



## *Emerald Bay Energy*

**Emerald Bay Energy Inc.  
Financial Statements  
For the nine months ended  
September 30, 2007  
(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 Discloses that its auditors have not reviewed the unaudited financial statements for the period ended September 30, 2007

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

	<b>September 30</b>	<b>December 31</b>
	<b>2007</b>	<b>2006</b>
		Audited
<b>Assets</b>		
<b>Current</b>		
Cash	\$ 55,201	\$ 261,944
Short term investments	50,445	60,560
Accounts receivable	1,124,899	999,101
Prepaid expenses	47,098	10,889
Inventory	9,193	6,400
	1,286,836	1,338,894
<b>Due from related parties</b>	<b>74,670</b>	<b>74,670</b>
<b>Property and equipment (Note 3)</b>	<b>4,820,408</b>	<b>3,911,678</b>
<b>License</b>	<b>33,457</b>	<b>41,177</b>
<b>Deposits</b>	<b>25,250</b>	<b>24,194</b>
	<b>\$ 6,240,621</b>	<b>\$ 5,390,613</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current</b>		
Bank demand loan (Note 5)	\$ 2,725,000	\$ 1,107,224
Accounts payable and accrued liabilities	1,486,762	1,494,430
	4,211,762	2,601,654
<b>Future tax liability</b>	<b>152,191</b>	<b>380,000</b>
<b>Asset retirement obligation</b>	<b>151,527</b>	<b>149,505</b>
	<b>4,515,480</b>	<b>3,131,159</b>
<b>Shareholders' equity</b>		
Share capital (Note 4(b))	4,932,351	5,072,851
Contributed surplus	515,718	369,623
Deficit	(3,722,928)	(3,183,020)
	1,725,141	2,259,454
	<b>\$ 6,240,621</b>	<b>\$ 5,390,613</b>

"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, Comprehensive Loss and Deficit**  
**Prepared by Management - Unaudited**

	For the three months ended		For the nine months ended	
	Sept 30 2007	Sept 30 2006	Sept 30 2007	Sept 30 2006
<b>Revenue</b>				
Petroleum and natural gas sales	\$ 498,972	\$ 675,409	\$ 1,754,002	\$ 2,212,363
Royalties	<u>( 90,254)</u>	<u>(143,329)</u>	<u>( 369,171)</u>	<u>( 615,779)</u>
	<u>408,718</u>	<u>532,080</u>	<u>1,384,831</u>	<u>1,596,584</u>
<b>Expenses</b>				
Operating	198,416	149,759	425,143	492,654
General and administrative	219,323	304,231	862,024	982,725
Stock option expense	-	5,783	5,595	175,162
Depletion, amortization and accretion	254,371	231,068	743,027	700,961
Interest	55,577	7,529	118,941	25,032
	<u>727,687</u>	<u>698,370</u>	<u>2,154,730</u>	<u>2,376,534</u>
<b>Loss from operations</b>	<u>(318,969)</u>	<u>(166,290)</u>	<u>(769,899)</u>	<u>(779,950)</u>
<b>Other income</b>				
Interest	579	1,627	2,182	1,627
<b>Loss for the period before tax</b>	<u>(318,390)</u>	<u>(164,663)</u>	<u>(767,717)</u>	<u>(778,323)</u>
<b>Income tax</b>				
Future income tax recovery	95,809	-	227,809	-
	<u>95,809</u>	<u>-</u>	<u>227,809</u>	<u>-</u>
<b>Net loss and comprehensive loss for the period</b>	<u>(222,581)</u>	<u>(164,663)</u>	<u>(539,908)</u>	<u>(778,323)</u>
Deficit, beginning of period	<u>(3,500,347)</u>	<u>(3,063,117)</u>	<u>(3,183,020)</u>	<u>(2,449,457)</u>
<b>Deficit, end of period</b>	<u>\$ (3,722,928)</u>	<u>\$ (3,227,780)</u>	<u>\$ (3,722,928)</u>	<u>\$ (3,227,780)</u>
<b>Loss per common share basic and diluted (Note 5(d))</b>				
	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.03)
<b>Weighted average number of shares</b>				
	27,903,277	27,903,277	27,903,277	27,857,189

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 2007	Sept 30 2006	Sept 30 2007	Sept 30 2006
<b>Cash flows from operating activities</b>				
Net loss for the period	\$ (222,581)	\$ (164,663)	\$ (539,908)	\$ (778,323)
Adjustments for:				
Depletion, amortization and accretion	251,797	228,494	735,306	693,240
Amortization of license fee	2,574	2,574	7,721	7,721
Future income taxes	(60,808)	-	(192,809)	-
Stock option expense	-	37,604	5,595	206,983
<b>Cash flow from operations</b>	<b>(29,018)</b>	<b>104,009</b>	<b>15,905</b>	<b>129,621</b>
<b>Changes in non-cash operating balances</b>				
Accounts receivable	(648,772)	(579,486)	(125,798)	(98,471)
Prepaid expenses and deposits	(37,265)	(2,550)	(37,265)	(9,731)
Accounts payable	573,329	(426,221)	26,832	(389,990)
Accrued liabilities	-	-	(69,500)	(89,500)
	<b>(141,726)</b>	<b>(1,008,257)</b>	<b>(189,826)</b>	<b>(587,692)</b>
<b>Cash flows from financing activities</b>				
Bank demand loan (repayment)	400,000	350,000	1,617,776	350,000
Repayment of note payable	-	-	-	(2,000,000)
Issuance of share capital, net of costs	-	(31,821)	-	61,666
	<b>400,000</b>	<b>318,179</b>	<b>1,617,776</b>	<b>(1,588,334)</b>
<b>Cash flows from investing activities</b>				
Purchases of property and equipment	(259,907)	198,252	(1,644,808)	(1,034,212)
<b>Increase (decrease) in cash and equivalents</b>				
	<b>(1,635)</b>	<b>(387,817)</b>	<b>(216,858)</b>	<b>(3,080,617)</b>
Cash and equivalents, beginning of period	107,281	574,898	322,504	3,267,698
<b>Cash and equivalents, end of period</b>	<b>\$ 105,646</b>	<b>\$ 187,081</b>	<b>\$ 105,646</b>	<b>\$ 187,081</b>

**Cash and equivalents, end of period**

	2007	2006
Cash	\$ 55,201	\$ 121,521
Short term investments	50,445	65,560
	<b>\$ 105,646</b>	<b>\$ 187,081</b>

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

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

**September 30, 2007**

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**1. Basis of Presentation**

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The interim financial statements of Emerald Bay Energy Inc. (the "Corporation") have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and are consistent with the presentation and disclosure in the audited financial statements and notes thereto for the year ended December 31, 2006. The interim financial statements contain disclosures which are supplemental to the Corporation's annual financial statements. Certain disclosures, which are normally required to be included in the notes to the annual financial statements, have been condensed or omitted. The interim financial statements should be read in conjunction with the Corporation's audited financial statements and notes thereof for the year ended December 31, 2006.

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**2. Adoption of New Accounting Policies**

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Effective January 1, 2007, the Corporation adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1530 "Comprehensive Income", Section 3251 "Equity", Section 3855 "Financial Instruments – Recognition and Measurement", Section 3861 "Financial Instruments – Disclosure and Presentation", and Section 3865 "Hedges". As required by the new standards, prior periods have not been restated. The adoption of these standards has had no material impact on the Corporation's new earnings or cash flows. The effects of the implementation of the new standards are discussed below.

**Comprehensive Income**

The Corporation does not have any items to be accounted as components of other comprehensive income ("OCI") and as a result comprehensive income equals net (loss) earnings.

**Financial Instruments**

The financial instruments standard establishes the recognition and measurement criteria for financial assets, financial liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the standard. Financial assets and financial liabilities "held-for-trading" are measured at fair value with changes in those fair values recognized in net earnings. Financial assets "available-for-sale" are measured at fair value, with changes in those fair values recognized in OCI. Financial assets "held-to-maturity", "loans and receivables", and "other financial liabilities" are measured at amortized cost using the effective interest method of amortization. All derivative instruments, including embedded derivatives, are recorded in the balance sheet at fair value unless they qualify for the expected purchase, sale or usage exemption. All changes in their fair value are recorded in earnings unless hedge accounting is applied in which case changes in fair value related to the effective portion of cash flow hedges is recognized in OCI.

**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**  
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**September 30, 2007**

**2. Adoption of New Accounting Policies - continued**

As a result of the adoption of these new standards, the Corporation has classified its accounts receivable as "loans and receivables". Deposits have been classified as "held-to-maturity". Accounts payable and accrued liabilities, distributions payable and bank debt have been classified as "other financial liabilities". The Corporation does not use derivative instruments.

The Corporation, also adopted Section 1506 – Accounting Changes the only impact of which is to provide disclosure of when an entity has not applied a new source of GAAP that has been issued but is not yet effective. This is the case with Section 1535 "Capital Disclosures" which are required to be adopted for fiscal years beginning on or after October 1, 2007. The Corporation will adopt this standard on January 1, 2008 and it is expected the only effect on the Corporation for adopting Section 1535 will be increased disclosure surrounding its objectives, policies and processes for managing capital.

**3. Property and Equipment**

**September 30, 2007**

	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>Net Book Value</u>
Petroleum and natural gas properties	\$ 7,628,147	\$ 2,866,048	\$ 4,762,099
Office furniture and equipment	<u>149,726</u>	<u>91,417</u>	<u>58,309</u>
	<u>\$ 7,777,873</u>	<u>\$ 2,957,465</u>	<u>\$ 4,820,408</u>

December 31, 2006

	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>Net Book Value</u>
Petroleum and natural gas properties	\$ 6,003,487	\$ 2,147,011	\$ 3,856,476
Office furniture and equipment	<u>132,371</u>	<u>77,169</u>	<u>55,202</u>
	<u>\$ 6,135,858</u>	<u>\$ 2,224,180</u>	<u>\$ 3,911,678</u>

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

The company applied the ceiling test to its petroleum and natural gas properties at December 31, 2006 and determined that there was no impairment of costs requiring a write down in either of its cost centres.

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**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**  
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**September 30, 2007**

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**4. Equity Instruments**

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

- b) Issued

	<u>September 30, 2007</u>	
	<u>Number of Shares</u>	<u>Amount</u>
Common shares issued and issuable for cash		
Balance, beginning of period	27,903,277	\$ 4,729,137
Subscription received		
Balance, end of period	<u>27,903,277</u>	<u>4,729,137</u>
Warrants outstanding beginning of period	6,434,500	343,714
Warrants issued		
Warrants expired	<u>(2,810,000)</u>	<u>(140,500)</u>
Balance, end of period	<u>3,624,500</u>	<u>203,214</u>
<b>Equity instruments balance Sept 30, 2007</b>		<b>\$ 4,932,351</b>

**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**  
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**September 30, 2007**

**4. 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.

	<b>Sept 30, 2007</b>		December 31, 2006	
	<b>Number of options</b>	<b>Weighted average exercise price</b>	Number of options	Weighted Average Exercise price
Stock options, beginning of period	2,429,904	\$ 0.26	1,179,904	\$ 0.27
Granted	-	-	1,250,000	0.25
Stock options outstanding, end of period	2,429,904	\$ 0.26	2,429,904	\$ 0.26
Exercisable, end of period	2,429,904	\$ 0.26	2,288,237	\$ 0.26

The stock options outstanding as at September 30, 2007 are as follows:

<u>Exercise prices</u>	<u>Options outstanding</u>			<u>Options exercisable</u>		
	Options outstanding	Weighted average remaining term (years)	Weighted average exercise price	Options exercisable	Weighted average exercise price	
\$0.19	104,904	0.3	\$ 0.19	104,904	\$ 0.19	
\$0.25	1,900,000	3.0	0.25	1,900,000	0.25	
\$0.32	425,000	1.5	0.32	425,000	0.32	
	<b>2,429,904</b>	<b>2.6</b>	<b>\$ 0.26</b>	<b>2,429,904</b>	<b>\$ 0.26</b>	

d) Diluted loss per share

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

**5. Bank Loan**

The Company has a \$3,000,000 (2006 - \$Nil) revolving operating demand loan, of which \$2,725,000 (2006 - Nil) plus accrued interest, has been drawn at September 30, 2007. Interest is calculated at the bank's prime rate plus 1.0%.

Security for the loan consists of a \$10,000,000 Debenture with a floating charge over all assets of the Company with a Negative Pledge and Undertaking to provide fixed charges on the Borrower's major producing petroleum properties at the request of the bank.

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**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**  
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**September 30, 2007**

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**6. Subsequent Event**

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Effective November 15, 2007 the Company sold its non-operated, minority interest in Section 14-39-24 W4M at Clive, Alberta. The property was sold to Fairborne Energy Ltd. for \$689,172. This property represented approximately 12 boe/day of the Company's current production. At December 31, 2006 this property was assessed a proved plus probable value discounted 10% of \$333,000 by GLJ Petroleum Consultants.