

# **Emerald Bay Energy Inc.**

Consolidated financial statements

**For the Years Ended December 31, 2017 and 2016**

(expressed in Canadian dollars)



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## Independent Auditor's Report

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### To the Shareholders of Emerald Bay Energy Inc.

We have audited the accompanying consolidated financial statements of Emerald Bay Energy Inc., which comprise the consolidated balance sheets as at December 31, 2017 and December 31, 2016 and the consolidated statements of comprehensive loss, changes in deficit, and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Emerald Bay Energy Inc. as at December 31, 2017 and December 31, 2016 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

### Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company will not generate significant revenues or profitable operations in the near future and there can be no assurance that it will achieve profitability in the future, as it incurred a loss of \$3,734,601, negative operating cash flow of \$832,533 for the year ended December 31, 2017, had a working capital deficiency of \$16,350,342 and has accumulated \$22,785,516 of losses as at December 31, 2017. These conditions indicate the existence of a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.

*BDO Canada LLP*

Chartered Professional Accountants  
Calgary, Alberta  
April 30, 2018

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# Emerald Bay Energy Inc.

## Consolidated Statements of Financial Position December 31, 2017 and 2016

	December 31, 2017 \$	December 31, 2016 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	124,949	180,642
Short-term investments	313,625	68,493
Trade and other receivables (note 23(b))	219,245	81,159
Prepaid expenses and deposits	34,234	26,189
<b>Total current assets</b>	<b>692,053</b>	<b>356,483</b>
<b>Non-current assets</b>		
Investment in PRI (note 6)	-	314,850
Investment in Partnership (note 9)	407,677	442,311
Exploration and evaluation assets and other intangible assets (note 10)	2,939,539	1,799,531
Property and equipment (note 8)	6,117,987	43,574
Goodwill (note 7 and 11)	340,025	-
<b>Total assets</b>	<b>10,497,281</b>	<b>2,956,749</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (note 23(c))	5,163,922	4,804,713
Shareholder indemnity (note 21(b))	322,624	332,388
Loan (note 13)	-	1,025,000
Short-term loan (note 16 (b))	501,800	-
Convertible debt (note 14)	363,175	376,000
Demand loan (note 15)	125,500	123,000
Short-term loan (note 16 (a))	225,000	314,262
Credit facility (note 17 (b))	3,980,263	-
Note payable (note 17 (a))	6,193,083	-
Other liabilities (note 21(c))	167,028	51,600
<b>Total current liabilities</b>	<b>17,042,395</b>	<b>7,026,963</b>
<b>Non-current liabilities</b>		
Decommissioning obligations (note 12)	968,985	426,314
Future tax liability (note 7(i) and 19)	340,025	-
Other liabilities (note 21(c))	-	20,338
<b>Total liabilities</b>	<b>18,351,405</b>	<b>7,473,615</b>
<b>Shareholders' deficit</b>		
Share capital (note 18(b))	12,767,569	12,248,793
Warrants (note 18(c))	556,389	510,171
Contributed surplus	1,886,474	1,886,474
Share purchase loan (note 20(a))	(247,970)	(247,970)
Deficit	(22,785,516)	(19,154,265)
Non-controlling interest in PRI	(36,879)	-
Accumulated other comprehensive income	5,809	239,931
<b>Total shareholders' deficit</b>	<b>(7,854,124)</b>	<b>(4,516,866)</b>
<b>Total liabilities and shareholders' deficit</b>	<b>10,497,281</b>	<b>2,956,749</b>
<b>Reporting entity and going concern (note 1)</b>		
<b>Commitments (note 21)</b>		

Approved on behalf of the Board of Directors

*"signed Shelby Beattie"*

Director

*"signed Kendall Dilling"*

Director

# Emerald Bay Energy Inc.

## Consolidated Statements of Comprehensive Loss For the years ended December 31, 2017 and 2016

	December 31, 2017	December 31, 2016
	\$	\$
<b>Revenue</b>		
Petroleum and natural gas revenue	435,458	13,440
Other revenue	30,913	23,000
Royalties	(7,714)	(2,156)
	<u>458,657</u>	<u>34,284</u>
<b>Operating expenses</b>		
Production and operating expenses	383,265	16,165
Loss on disposal of Horseshoe investment (note 9)	34,634	-
Depletion and depreciation (note 8)	220,943	16,527
Goodwill impairment on acquisition of businesses (note 7)	1,768,282	-
Goodwill impairment at year-end (Note 11)	178,109	-
Impairment of exploration and evaluation assets (note 10)	279,370	306,159
Impairment on property and equipment (note 11)	20,780	-
General and administrative	873,265	645,035
Bad debt (recovery) expense (note 23(b))	180,421	(52,869)
Foreign exchange (gain) loss	44,859	(29,572)
	<u>3,983,928</u>	<u>901,445</u>
<b>Results from operating activities</b>	<u>(3,525,271)</u>	<u>(867,161)</u>
<b>Finance expense</b>		
Interest expense	(468,355)	(211,908)
Accretion of decommissioning obligations (note 12)	(17,249)	(3,438)
Accretion of other liabilities (note 21(c))	(19,239)	(16,268)
<b>Net finance expense</b>	<u>(504,843)</u>	<u>(231,614)</u>
<b>Other income and expenses</b>		
Impairment on previously held interest in PRI	(291,635)	-
Movement in available for sale investment reclassified to net income (note 6)	215,894	-
Gain on abandonment and reclamation (note 12)	193,145	28,895
<b>Net other income and expenses</b>	<u>117,404</u>	<u>28,895</u>
<b>Net loss before income tax</b>	<u>(3,912,710)</u>	<u>(1,069,880)</u>
Income tax recovery (note 19)	178,109	-
<b>Net loss for the year</b>	<u>(3,734,601)</u>	<u>(1,069,880)</u>
<b>Other comprehensive loss</b>		
Movement in available for sale investment reclassified to net income (note 6)	(215,894)	-
Net loss on available for sale financial assets (note 6)	-	(28,199)
Foreign currency translation adjustment	(24,304)	(3,340)
<b>Total comprehensive loss for the year</b>	<u>(3,974,799)</u>	<u>(1,101,419)</u>
<b>Attributable to:</b>		
<b>Equity holders of the parent</b>	<u>(3,631,251)</u>	<u>(1,069,880)</u>
<b>Non-controlling interests</b>	<u>(103,351)</u>	<u>-</u>
<b>Basic and diluted loss per share (note 17(f))</b>	<u>(0.02)</u>	<u>(0.01)</u>
<b>Weighted average number of common shares outstanding during the year</b>	<u>210,509,732</u>	<u>193,145,708</u>

# Emerald Bay Energy Inc.

## Statements of Changes in Deficit

For the years ended December 31, 2017 and 2016

	Share capital \$	P Warrants \$	Contributed surplus \$	Share purchase loan \$	Deficit \$	Non-Controlling Interest \$	Accumulated other comprehensive loss \$	Total deficit \$
<b>Balance, December 31, 2015</b>	11,447,478	528,898	1,886,474	(247,970)	(18,084,385)	-	271,470	(4,198,035)
Reallocation expiry of warrants	632,428	(632,428)	-	-	-	-	-	-
Issue costs for expired warrant	(103,533)	103,533	-	-	-	-	-	-
Loss for the year	-	-	-	-	(1,069,880)	-	-	(1,069,880)
Convertible debenture	272,420	510,168	-	-	-	-	-	782,588
Movement in available for sale investment	-	-	-	-	-	-	(28,199)	(28,199)
Foreign exchange translation to presentation currency	-	-	-	-	-	-	(3,340)	(3,340)
<b>Balance, December 31, 2016</b>	<b>12,248,793</b>	<b>510,171</b>	<b>1,886,474</b>	<b>(247,970)</b>	<b>(19,154,265)</b>	-	<b>239,931</b>	<b>(4,516,866)</b>
Reallocation expiry of warrants	516,232	(516,232)	-	-	-	-	-	-
Issue costs for expired warrant	(6,061)	6,061	-	-	-	-	-	-
Loss for the year	-	-	-	-	(3,631,251)	(103,351)	-	(3,734,601)
Private placement, net of issue costs	8,605	556,389	-	-	-	-	-	564,994
Movement in available for sale investment	-	-	-	-	-	-	(215,894)	(215,894)
Acquisition of subsidiary (note 7)	-	-	-	-	-	72,548	-	72,548
Foreign exchange translation to presentation currency	-	-	-	-	-	(6,076)	(18,228)	(24,304)
<b>Balance, December 31, 2017</b>	<b>12,767,569</b>	<b>556,389</b>	<b>1,886,474</b>	<b>(247,970)</b>	<b>(22,785,516)</b>	<b>(36,879)</b>	<b>5,809</b>	<b>(7,854,124)</b>

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

# Emerald Bay Energy Inc.

## Consolidated Statements of Cash Flows

For the years ended December 31, 2017 and 2016

	December 31, 2017	December 31, 2016
	\$	\$
<b>Cash (used in) provided by:</b>		
<b>Operating activities</b>		
Net loss for the year	(3,734,601)	(1,069,880)
Adjustments for:		
Depletion and depreciation (note 8)	220,943	16,527
Goodwill impairment on acquisition of businesses (note 7)	1,768,282	-
Goodwill impairment at year-end (note 11)	178,109	-
Impairment of transferred to property and equipment (note 11)	20,780	-
Impairment of exploration and evaluation assets (note 10)	279,370	306,159
Accretion of decommissioning obligation (note 12)	17,249	3,438
Accrued Interest expense	345,454	
Accretion of other liabilities (Note 21(c))	19,239	16,268
Gain on abandonment and reclamation (note 12)	(193,145)	(28,895)
Loss on investment in PRI (note 7)	291,635	-
Loss on disposal of partnership	34,634	-
Income tax recovery (note 19)	(178,109)	-
Unrealized foreign exchange gain	(182,206)	14,274
	<u>(1,112,366)</u>	<u>(742,109)</u>
Change in trade and other receivables	(5,979)	46,742
Change in prepaid expenses and deposits	(8,045)	57,929
Change in accounts payable and accrued liabilities	303,621	371,835
Change in shareholder indemnity (note 21(b))	(9,764)	-
	<u>(832,533)</u>	<u>(265,603)</u>
<b>Investing activities</b>		
Property and equipment expenditures (note 8)	245	(15,914)
Exploration and evaluation expenditures (note 10)	(98,762)	(220,564)
Proceeds of disposition of corporate assets (note 8)	-	16,633
Cash acquired on acquisition in PRI (note 7)	182,863	-
	<u>84,346</u>	<u>(219,845)</u>
<b>Financing activities</b>		
Proceeds from issuance of common shares, net of issue costs (note 18(b))	564,994	(17,412)
Repayment of long term debt (note 21(c))	-	(34,271)
Receipt of short-term loan (note 17)	125,000	314,262
Receipt of demand loan (note 16)	2,500	-
	<u>692,494</u>	<u>262,579</u>
<b>Change in cash and cash equivalents</b>	<b>(55,693)</b>	<b>(222,869)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>180,642</b>	<b>403,511</b>
<b>Cash and cash equivalents, end of year</b>	<b>124,949</b>	<b>180,642</b>

### Supplemental cash flow information (note 22)

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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## **1 Reporting entity and going concern**

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, Canada and Texas, USA. The Company is listed on the TSX Venture exchange under the symbol “EBY.V”. The Company’s registered head office is located at #3A, 4015 – 1 Street South East, Calgary, Alberta, Canada T2G 4X7.

At December 31, 2017, the Company had not yet achieved profitable operations, had an accumulated deficit of \$22,785,516 since its inception (December 31, 2016 - \$19,154,165), had negative cash flows used in operations of \$832,533 (December 31, 2016 - \$265,603) and had a working capital deficiency of \$16,350,342 (December 31, 2016 - \$6,670,480) (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 are 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.

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements  
For the years ended December 31, 2017 and 2016

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## **2 Basis of presentation**

### a) Statement of compliance:

These annual consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The Board of Directors approved the consolidated financial statements on April 30, 2018.

### b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments and available for sale financial investments which are measured at fair value, as explained in note 3 – Significant accounting policies.

### c) Basis of consolidation:

These consolidated financial statements include the accounts of the Company and its United States branch, and Emerald Bay Texas Inc., its wholly-owned and controlled subsidiary; as well as Production Resources, Inc. where the Company has a 75% ownership position. Control exists when the Company has the power over the investee, exposure or rights to variable returns from its involvement and has the ability to affect those returns through its power over the investee. The financial statements of subsidiaries, including entities which the Company controls, are included in the consolidated financial statements from the date that control commences until the date that control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. All intercompany transactions and balances have been eliminated.

### d) Nature and purpose of equity and reserves:

The reserves recorded in equity on the Company’s consolidated statement of financial position include ‘contributed surplus’, ‘Accumulated other comprehensive loss’, and ‘Deficit’.

‘Contributed surplus’ is used to recognize the value of stock options and broker warrants prior to exercise.

‘Accumulated other comprehensive loss’ is used to recognize the foreign exchange gain or loss resulting from the translation of the Corporation’s foreign subsidiary.

‘Deficit’ is used to record the Corporation’s change in deficit from profit or loss from year to year.



# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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e) Use of estimates and judgments:

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.

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.

*Functional currency determination*

The functional currency for the Company and its subsidiaries is the currency of the primary economic environment in which the entity operates. Determination of functional currency is conducted through an analysis of the consideration factors identified in IAS 21. The Effects of Changes in Foreign Exchange Rates and may involve certain judgements to determine the primary economic environment. The Company reconsiders the functional currency of its entities if there is a change in events and conditions which determine the primary economic environment. Significant changes to those underlying factors could cause a change to the functional currency.

Significant estimates and assumptions

*Reserve estimates*

*Reserves are estimates of the amount of hydrocarbons that can be economically and legally extracted from the Company’s oil and gas properties. The Company’s estimates its commercial reserves and resources based on information compiled by appropriately qualified persons relating to the geological and technical data on the size, depth, shape and grade of the hydrocarbon body and suitable production techniques and recovery rates. Commercial reserves are determined using estimates of oil and gas in place, recovery factors and future commodity prices, the latter having an impact on the total amount of recoverable reserves. Future development costs are estimated using assumptions as to the number of wells required to produce the commercial reserves,*

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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## *Financial instrument fair values*

During the year ended Dec. 31, 2017, the Company entered into financial instruments that are accounted for at fair value, with the initial and subsequent changes in fair value affecting other comprehensive income in the period the change occurs. The fair values of financial instruments are classified within three levels, with Level III fair values determined using inputs for the asset or liability that are not readily observable. Some of the Company's fair values are included in Level III because they require the use of internal valuation techniques or models as well as unobservable inputs to determine fair value. The determination of the fair value of these instruments can be complex and relies on judgments and estimates. These fair value estimates may not necessarily be indicative of the amounts that could be realized or settled, and changes in these assumptions could affect the reported fair value of the financial instruments.

Fair values can fluctuate significantly and can be favourable or unfavourable depending on current market conditions.

## *Decommissioning obligations*

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.

## *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 ("FVLCTS") and its value in use. The Company used the calculation of FVLCTS to determine the fair value of its CGUs. In determining the FVLCTS, 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.

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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## **3 Significant accounting policies**

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements.

### **Business combinations and goodwill**

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling Interest (NCI) in the acquiree. For each business combination, the Group elects whether to measure NCI in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree. Those acquired petroleum reserves and resources that can be reliably measured are recognized separately in the assessment of fair values on acquisition. Other potential reserves, resources and rights, for which fair values cannot be reliably measured, are not recognized separately, but instead are subsumed in goodwill.

If the business combination is achieved in stages, any previously held equity interest is measured at its acquisition date fair value, and any resulting gain or loss is recognized in the statement of profit or loss and other comprehensive income.

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 Financial Instruments: Recognition and Measurement is measured at fair value, with changes in fair value recognized either in the statement of profit or loss or as a change to other comprehensive income. If the contingent consideration is not within the scope of IAS 39, it is measured in accordance with the appropriate IFRS. Contingent consideration that is classified as equity is not remeasured, and subsequent settlement is accounted for within equity.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognized for NCI over the fair value of the identifiable net assets acquired and liabilities assumed. If the fair value of the identifiable net assets acquired is in excess of the aggregate consideration transferred (bargain purchase), before recognizing a gain, the Group reassesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognized at the acquisition date. If the assessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognized in the statement of profit or loss and other comprehensive income.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's CGUs that are expected to benefit from the

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

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combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill forms part of a CGU and part of the operation in that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed of in these circumstances is measured based on the relative values of the disposed operation and the portion of the CGU retained.

## **Cash and cash equivalents**

Cash and cash equivalents include cash on hand and deposits held with banks. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management, whereby management has the legally enforceable right and ability and intent to net bank overdrafts against cash, are included as a component of cash for the purpose of the consolidated statement of cash flows. Cash equivalents comprise term deposits held with banks and other short-term highly liquid investments with original maturities of three months or less.

## **Financial instruments**

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognized amount and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

Common shares are classified as equity. Incremental costs directly attributable to the issuance of common shares are recognized as a deduction from equity, net of any tax effects.

### *Non-derivative financial instruments:*

Non-derivative financial instruments are recognized initially at fair value. Subsequent to the initial recognition, non-derivative financial instruments are designated into one of the following categories and measured as described below:

- (i) Financial assets and liabilities at fair value through profit or loss: Financial assets and liabilities at fair value through profit or loss are either "held for trading" or have been "designated at fair value through profit or loss". In both cases the financial assets and financial liabilities are measured at fair value with changes in fair value recognized in the consolidated statement of comprehensive loss. A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Transaction costs are expensed in the consolidated statement of comprehensive loss.

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements

For the years ended December 31, 2017 and 2016

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- (ii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables are comprised of trade and other receivables and are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received, less when material, a discount to reduce the loans and receivables to fair value. Transaction costs pertaining to these financial instruments are added to the financial instrument. Subsequently, loans and receivables are measured at amortized cost using the effective interest rate method less a provision for impairment.
- (iii) Available-for-sale financial assets: Available-for-sale financial assets are those non-derivative financial assets that are designated as such or that have not been classified as another type of financial asset, and are measured at fair value through Other Comprehensive Loss. Available-for-sale financial assets are measured at cost if fair value is not reliably measurable.
- (iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities, shareholder indemnity, loan, and the convertible debt. Accounts payable and accrued liabilities and the shareholder indemnity are initially recognized at the amount required to be paid, less when material, a discount to reduce the payables to fair value. Subsequently, accounts payable and accrued liabilities and the shareholder indemnity are measured at amortized cost using the effective interest rate method. The loan, the convertible debt (excluding the derivative relating to the conversion option) are recognized initially at fair value and subsequently at amortized cost using the effective interest rate method. The fair value of transaction costs to acquire debt are netted against the debt instrument, and through a non-cash finance expense, the debt is accreted back to the principal balance over the life of the debt.

Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

### *Derivative financial instruments:*

The Company may enter into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the consolidated statement of financial position at fair value. Transaction costs are recognized in the consolidated statement of comprehensive loss when incurred.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related. Conversion features that are accounted for as derivative liabilities are accounted for separately from the host instrument as the fair value of the conversion feature is affected by

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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changes in the fair value of the Company's shares, and the fair value of the host instrument is not. Changes in the fair value of separable embedded derivatives are recognized immediately in the consolidated statement of comprehensive loss.

## **Property and equipment and exploration and evaluation assets**

*Recognition and measurement:*

(i) E&E expenditures:

Pre-license costs are recognized in the consolidated statement of comprehensive loss as incurred.

All costs associated with the exploration and evaluation of oil and natural gas reserves are initially capitalized. Exploration and evaluation costs are those expenditures for an area where technical feasibility and commercial viability has not yet been determined. These costs include unproven property acquisition costs, exploration costs, geological and geophysical costs, decommissioning costs, E&E drilling, and sampling and appraisals.

When an area is determined to be technically feasible and commercially viable, the accumulated costs are tested for impairment and transferred to property and equipment. When an area is determined not to be technically feasible and commercially viable or the Company decides not to continue with its activity, the unrecoverable costs are charged to the consolidated statement of comprehensive loss as E&E expense.

(ii) Property and equipment:

All costs directly associated with the development of oil and gas reserves are capitalized on an area-by-area basis. Development costs include expenditures for areas where technical feasibility and commercial viability has been determined. These costs include proven property acquisitions, development drilling, completion, gathering and infrastructure, decommissioning costs and transfers of E&E assets.

Costs accumulated within each area are depleted using the unit-of-production method based on proven reserves incorporating estimated future prices and costs. Costs subject to depletion include estimated future costs to be incurred in developing proven reserves. Costs of major development projects are excluded from the costs subject to depletion unless they are available for use.

Gains and losses on disposal of an item of property and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized within "operating expenses" in consolidated statement of comprehensive loss.

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements

For the years ended December 31, 2017 and 2016

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- (iii) Property and equipment – corporate and other:

Property and equipment – corporate and other is carried at cost and amortized over the estimated useful lives of the assets at various rates per annum calculated on a declining balance basis. Amortization is charged at half rates in the year of acquisition.

The Company uses the following rates:

<b>Asset class</b>	<b>Rate</b>
Furniture and equipment and leasehold improvements	20%
Computer Hardware	30%
Automotive	30%

### *Subsequent costs:*

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property and equipment are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in the consolidated statement of comprehensive loss as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in the consolidated statement of comprehensive loss as incurred.

### **Impairment**

#### *Financial assets:*

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset. Objective evidence that financial assets are impaired can include: significant financial difficulty of the issuer or counterparty; the potential for loss is significant; a prolonged decline in value (defined as a decline in value lasting longer than one year); default or delinquency of payments; or it is probable that the borrower will enter bankruptcy or financial re-organization.

- (i) Financial assets carried at amortized cost: An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. The carrying amount of the asset is reduced by this amount

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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and losses are recognized in the consolidated statement of comprehensive loss and through the use of an allowance account.

- (ii) Available for sale financial assets: The impairment loss in respect of an available for sale financial asset is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the consolidated statement of comprehensive loss.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the reversal can be related objectively to an event occurring after the impairment loss was recognized. The reversal is recognized in the consolidated statement of comprehensive loss or credited against the allowance account. Impairment losses on available for sale equity instruments are not reversed.

### *Non-financial assets:*

The carrying amounts of the Company's non-financial assets, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For other intangible assets that have indefinite lives or that are not yet available for use, an impairment test is completed each year. E&E assets are assessed for impairment when they are reclassified to property and equipment as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The Company considers its Canadian assets as a CGU and its Texas assets as a separate CGU.

The recoverable amount of an asset or a CGU is the greater of its value in use and its FVLCTS. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset or CGU. FVLCTS is based on available market information, where applicable. In the absence of such information, FVLCTS is determined using discounted future net cash flows of proved and probable reserves using forecast prices and costs.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the consolidated statement of comprehensive loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

### **Share-based payments**

The Company issues stock options to directors, officers and other consultants, which are deemed employees. The fair value of options granted to employees is measured at grant date, using the Black-Scholes option pricing model, and is recognized over the vesting period, using a graded vesting model. The fair value is recognized as an expense within operations with a corresponding



# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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increase in contributed surplus. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

The fair value of warrants issued as part of the private placements is measured at the closing date of the private placement using the Black-Scholes option pricing model. The fair value is recognized as a deduction against share capital with a corresponding increase in contributed surplus.

If and when the stock options and/or warrants are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

## **Provisions**

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

## **Decommissioning obligations**

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. A provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the consolidated statement of financial position date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance expense whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning liabilities are charged against the provision to the extent the provision was established.

## **Revenue**

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product are transferred to the buyer which is usually when legal title passes to the external party. This is generally at the time product enters the pipeline.

## **Finance income and expenses**

Finance expense comprises interest expense on borrowings and accretion of the discount on provisions.

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

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## **Income tax**

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the consolidated statement of comprehensive loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted as at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

## **Earnings per share**

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

## **Currency translation**

### *Functional and presentation currency*

The functional currency for each branch within the Company is the currency of the primary economic environment in which it operates. The functional currency for the United States branch and United States subsidiary (Production Resources Inc.) is the United States dollar. The functional currency for the Canadian branch is the Canadian dollar. These consolidated financial statements are presented in Canadian dollars. Intercompany balances and transactions, and any unrealized

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

The results and financial position of the subsidiaries that have a functional currency different from the presentation currency are translated into Canadian dollars, the presentation currency, as follows:

- Assets and liabilities are translated at the closing exchange rate at the date of the consolidated statement of financial position;
- Income and expenses are translated at the average exchange rates during the period; and
- All resulting exchange differences are charged/credited to the currency translation adjustment in Other Comprehensive Loss.

### *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation of monetary assets and liabilities, within the United States branch, denominated in currencies other than an entity's functional currency are recognized in the consolidated statement of comprehensive loss.

### **Flow-through shares**

From time to time the Company will issue flow-through common shares to finance a portion of its exploration program. These shares transfer the tax deductibility of qualifying resource expenditures to investors. On issuance, the Company splits the flow-through shares into i) a flow-through share premium, equal to the estimated premium, if any, investors pay for the flow-through feature, which is recognized as a liability, and ii) share capital. When expenses are renounced, the Company derecognizes the liability and recognizes a deferred tax liability for the amount of tax reduction renounced to the shareholders. The premium is recognized as other income and the related deferred tax is recognized as a tax provision.

Proceeds received from the issuance of flow-through shares are restricted to be used only for Canadian resource property exploration expenditures. The Company may also be subject to a Part XII.6 tax on flow-through proceeds renounced under the Look-back Rule, in accordance with Government of Canada flow-through regulations. When applicable, this tax is accrued as a financial expense until paid.

### **Joint operations**

Many of the Company's oil and natural gas activities involve joint operations. A joint operation is a type of arrangement whereby the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities relating to the joint operation. The consolidated financial statements include the Company's share of these joint operations and a proportionate share of the relevant revenue and related costs.

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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## **4 Recent accounting pronouncements**

Certain pronouncements were issued by “IASB” or International Financial Reporting Interpretation Committee (“IFRIC”) that are mandatory for accounting periods beginning after January 1, 2015 or later periods.

The following new accounting standards, amendments to accounting standards and interpretations, have not been early adopted in these consolidated financial statements. The Company is currently assessing the impact, if any, of this new guidance on the Company’s future results and financial position:

IFRS 9, “Financial Instruments”: In July 2014, the IASB completed the final phase of its project to replace IAS 39, the current standard on the recognition and measurement of financial instruments. IFRS 9 is now the new standard which sets out the recognition and measurement requirements for financial instruments and some contracts to buy or sell non-financial items. IFRS 9 provides a single model of classifying and measuring financial assets and liabilities and provides for only two classification categories: amortized cost and fair value. Hedge accounting requirements have also been updated in the new standard and are now more aligned with the risk management activities of an entity. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. Early adoption is permitted; however, if an entity elects to apply this standard early, it must disclose that fact and apply all of the requirements in this standard at the same time. The Company is in the process of accessing the impact on adoption of IFRS 9 and it is anticipated that the adoption of IFRS 9 will not have a material impact on the Company’s consolidated financial statements.

IFRS 15, “Revenue from Contracts with Customers:” IFRS 15 was issued in May 2014 and applies to contracts with customers, excluding, most notably, insurance and leasing contracts. IFRS 15 prescribes a framework in accounting for revenues from contracts within its scope, including (a) identifying the contract, (b) identify separate performance obligations in the contract, (c) determine the transaction price of the contract, (d) allocate the transaction price to the performance obligations and (e) recognize revenues when each performance obligation is satisfied. This standard comes into effect January 1, 2018 and is applied retrospectively. IFRS 15 also prescribes additional financial statement presentations and disclosures. The Company’s evaluation of IFRS 15 is ongoing and not complete. The IASB has issued and may issue in the future, interpretative guidance, which may cause its evaluation to change. The Company does not currently believe IFRS 15 will have a material effect on its consolidated financial statements.

IFRS 16, “Leases”: In January 2016, the IASB issued the standard to replace IAS 17 “Leases”. For lessees applying IFRS 16, a single recognition and measurement model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted.

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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It is anticipated that the adoption of IFRS 16 will have impact on the Company's consolidated balance sheet due to the operating lease commitments as disclosed in note 17.

## **5 Determination of fair values**

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

### *Property and equipment on acquisition:*

The fair value of property and equipment on acquisition is the estimated amount for which property and equipment and E&E assets could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties each acted knowledgeably, prudently and without compulsion. The fair value of oil and natural gas assets (included in property and equipment) is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports.

### *Cash and cash equivalents, trade and other receivables and accounts payable and accrued liabilities:*

At December 31, 2017 and December 31, 2016, the fair value of these balances approximated their carrying value due to their short term to maturity.

### *Share-based payments, warrants and finder's options:*

The fair value of employee stock options, warrants and the finder's options are measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

### *Investments:*

Fair values are determined using inputs (Level III) for the asset or liability that are not readily observable.

In estimating the fair value of such investments, the Company uses a discounted cash flow method, and makes estimates and assumptions about forward reserve prices, production, capital expenditures, asset retirement costs, and other related cash inflows and outflows over the life of the assets, as well as the remaining life of the facilities.

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements

For the years ended December 31, 2017 and 2016

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Appropriate discount rates reflecting the risks specific to the investment are used in the valuations. These estimates and assumptions are susceptible to change from period to period and actual results can, and often do, differ from the estimates, and can have either a positive or negative impact on the estimate of the fair value of the instrument, and may be material.

## 6 Equity investment in PRI

The Company's interest in the share capital of PRI was 10% at December 31, 2016, and accordingly the Company previously accounted for the investment as an available for sale investment.

Effective July 1, 2017 the Company acquired an additional interest 65% in PRI, which resulted in the Company controlling PRI. See Note 7 regarding the acquisition of PRI. As a result, previous changes in value of the equity interest of \$215,894 that were previously recognized in other comprehensive income (e.g. because the investment was classified as available-for-sale) were reclassified from equity to profit or loss.

The investment in PRI as at December 31, 2017 is as follows:

	\$
<b>Net investment, December 31, 2015</b>	<b>\$343,049</b>
Fair value adjustment at December 31, 2016	(28,199)
<b>Net investment, December 31, 2016</b>	<b>\$314,850</b>
Impairment of investment	(291,635)
Remaining balance recognized in acquisition (note 7)	(23,215)
<b>Net investment, December 31, 2017</b>	<b>\$ -</b>

## 7 Business Combinations

### i) Production Resources Inc. Acquisition

The Company acquired 65% of the voting shares of Production Resources Inc. ("PRI"), a company holding oil and gas properties in Texas, US on June 30, 2017. The Company previously held 10% of the voting shares and this increased the Company's ownership in PRI to 75%, which gave the Company control over PRI's operations.

The Company elected to measure the non-controlling interest in the acquiree at the proportionate share of its interest in the acquiree's identifiable net assets.

# Emerald Bay Energy Inc.

## Notes to the Consolidated financial statements For the years ended December 31, 2017 and 2016

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The fair values of the identifiable assets and liabilities of PRI as at the date of acquisition were:

	Fair value recognized at acquisition (\$CAD)
Property and equipment (Note 8)	\$ 5,706,399
Other current assets	377,239
Cash	182,863
	<hr/> \$ 6,266,501
Trade and other payables	(55,588)
Loan payable – short-term (Note 16)	(17,413)
Demand loan (Note 15)	(519,080)
Credit facility (Note 17)	(4,473,204)
Loan payable – long-term (Note 17)	(50,477)
Deferred tax liability	(518,134)
Decommissioning obligations (Note 12)	(342,413)
	<hr/> (5,976,309)
Total identifiable net assets at fair value	290,192
Non-controlling interest (25% of net assets)	(72,548)
Previously held interest (10% of net assets)	(23,215)
Total net assets acquired	<hr/> 194,429
Goodwill	518,134
Day 2 goodwill impairment	1,601,617
Total consideration	<hr/> \$ 2,314,180

The Company fair valued its previously held interest of 10% at the date of acquisition and recorded a loss of \$291,635.

The proceeds from the loan (Note 17(a)) were assumed as part of the acquisition and therefore no cash was exchanged between the transacting parties. The loan is due on demand and therefore approximates fair value.

The net assets recognized in the consolidated financial statements were based on an assessment of their fair value at the acquisition date. The oil and gas properties were fair valued based on a reserve report prepared by an independent reserve engineer and had a fair value of \$5,483,152 at the acquisition date, the Company also acquired corporate and other assets of \$223,247.

The Company recorded impairment on goodwill immediately after acquisition as there were no synergies to be gained from combining PRI's assets with the Company's existing asset portfolio. The remaining goodwill of \$518,134 is due to the deferred tax liabilities recognized as a result of the acquisition.

From the date of acquisition (June 30, 2017) to December 31, 2017, PRI contributed \$354,198 to consolidated revenue and (\$400,661) to consolidated loss.

The consideration paid of \$2,314,180 consistent of a Note Payable assumed (Note 17 (a)).

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements  
For the years ended December 31, 2017 and 2016

## ii) Cardium Acquisition

	Fair value recognized at acquisition (\$CAD)	
	\$	
Oil and gas properties (Note 8)	115,000	
Decommissioning obligations (Note 12)	(6,665)	
Total identifiable net assets at fair value	108,335	
Day 2 impairment loss arising on acquisition	166,665	
Total consideration	\$ 275,000	

The Company acquired oil and gas properties in Edson, Alberta, Canada for consideration paid of \$275,000, which consisted of a Note Payable (note 17 (a)). The net assets recognized in the consolidated financial statements were based on an assessment of their fair value at the acquisition date (June 30, 2017). The oil and gas properties were fair valued using a reserve report prepared by an independent reserve engineer. Net assets on the acquisition totaled \$108,335. Therefore, the day 2 goodwill impairment was \$166,665.

The Company recorded impairment on goodwill immediately after acquisition as there were no synergies to be gained from combining the assets acquired with the Company's existing asset portfolio.

From the date of acquisition (June 30, 2017) to December 31, 2017, Cardium properties contributed \$33,150 to consolidated revenue and \$16,305 to consolidated profit. If the acquisition had taken place at the beginning of the year, consolidated revenue and profit for the 2017 year would have been \$66,300 and \$32,609, respectively.

## 8 Property and equipment

	Oil and natural gas interests \$	Corporate and other \$	Total \$
<b>Cost, December 31, 2016</b>	<b>4,227,898</b>	<b>190,996</b>	<b>4,418,894</b>
Additions	394,196	-	394,196
Acquisitions	5,558,721	223,247	5,781,968
Transfers from E&E (note 10)	153,085	-	153,085
Foreign currency translation	(21,993)	(7,432)	(29,425)
<b>Cost, December 31, 2017</b>	<b>10,311,907</b>	<b>406,811</b>	<b>10,718,718</b>
Accumulated depletion, depreciation and impairment, beginning of year	(4,196,828)	(178,492)	(4,375,320)
Impairment (note 11)	(20,780)	-	(20,780)
Depreciation and depletion for the year	(189,601)	(31,342)	(220,943)
Foreign currency translation	8,771	7,541	16,312
<b>Carrying value, December 31, 2017</b>	<b>5,913,469</b>	<b>204,518</b>	<b>6,117,987</b>



# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements  
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	Oil and natural gas interests \$	Corporate and other \$	Total \$
<b>Cost, December 31, 2015</b>	<b>4,227,898</b>	<b>192,388</b>	<b>4,420,286</b>
Additions	-	15,914	15,914
Dispositions	-	(16,633)	(16,633)
Foreign currency translation	-	(673)	(673)
<b>Cost, December 31, 2016</b>	<b>4,227,898</b>	<b>190,996</b>	<b>4,418,894</b>
Accumulated depletion, depreciation and impairment, beginning of year	(4,192,339)	(167,087)	(4,359,426)
Depreciation and depletion for the year	(4,489)	(12,038)	(16,527)
Foreign currency translation	-	633	633
<b>Carrying value, December 31, 2016</b>	<b>31,070</b>	<b>12,504</b>	<b>43,574</b>

## 9 Investment in Partnership

Horseshoe LP is a privately held partnership with no active public market and no observable outputs as the partnership only recently began operating and has no extensive history of activity. The Company assessed the value of its initial partnership purchase using the price at which third parties were willing to purchase a partnership interest. For subsequent quarterly and annual reporting, unless additional partnership units are sold to a third party, the Company determines the fair value of its investment in Horseshoe based on the costs incurred as there is insufficient recent information available to measure fair value. During the year ended December 31, 2017, the Company did not participate in a capital call initiated by unit holders of the Partnership and alternatively was required to settle by returning its holding of 34,634 units in the Partnership. The current price per share of the remaining units reflected the existing fair value of units held by the Company. There also have been no indicators to suggest that the unit issuance by the Partnership is not representative of fair value.

The investment in Partnership as at December 31, 2017 is as follows:

	\$
<b>Net investment, December 31, 2016 and 2015</b>	<b>442,311</b>
Disposal of units in Partnership	(34,634)
<b>Net investment, December 31, 2017</b>	<b>407,677</b>

# Emerald Bay Energy Inc.

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## 10 Exploration and evaluation assets

	E&E assets
	\$
<b>Balance, December 31, 2015</b>	<b>1,940,471</b>
Additions	220,564
Revisions in decommissioning liability	7,002
Impairment	(306,159)
Foreign currency translation	(62,347)
<b>Balance, December 31, 2016</b>	<b>1,799,531</b>
Guadalupe acquisition	1,689,359
Impairment on acquisition	(279,370)
Other additions	98,761
Revision in decommissioning liability	4,576
Transfer to property and equipment (note 8)	(153,085)
Foreign currency translation	(220,234)
<b>Balance, December 31, 2017</b>	<b>2,939,538</b>

E&E assets consist of the Company's exploration projects which are pending the determination of technical feasibility and commercial viability. As at December 31, 2017, the Company incurred an amount of \$98,761 on E&E expenditures (December 31, 2016 - \$220,564). The additions represent the acquisition of undeveloped land and drilling activity within Texas. These E&E assets will be transferred to property and equipment when technical feasibility and commercial viability have been established.

The Company closed a transaction on June 30, 2017 whereby it increased its interest in the Wooden Horse and Nash Creek projects in Guadalupe County, Texas from 27.8% to 50.0%, for aggregate proceeds of \$1,689,359 included in the acquisition line above. The Company recorded impairment loss of \$279,370 for interest related to properties acquired that the Company has no plans to develop and are considered impaired at the date of acquisition. Consideration for the Guadalupe acquisition was the assumption of a Note Payable (Note 17).

There was no further write down for the year ended December 31, 2017 (December 31, 2016 - \$306,159). The impairment for 2016 was recognized upon a review of each exploration license or field, carried out, at least annually, to confirm whether the Company intends further appraisal activity or to otherwise extract value from the property.

## 11 Impairment loss

The Company determined the recoverable amount of the CGU based FVLCTS measured using the discounted cash flow approach. The cash flow projection was taken from the reserve report, using a discount of 15% (pre-tax) and it was determined that there was \$20,780 of impairment.

The Company recognized goodwill impairment of \$178,109 at year-end as a result of a reduction in US tax rates (from the US Tax Cuts and Jobs Act enacted on December 22, 2017) whereby the Company is required to revalue its United States deferred tax liabilities based on the rates they are expected to reverse at in the future (note 19).

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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## **12 Decommissioning obligations**

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites and gathering systems. The total decommissioning obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the decommissioning obligations to be \$968,985 as at December 31, 2017 (December 31, 2016 - \$426,314) based on an undiscounted total future liability of \$1,375,661 (December 31, 2016 - \$447,124). These payments are expected to be made over the next 2 to 25 years. The obligations have been calculated using an inflation rate of 1.90% and a discount factor, being the risk-free rate related to the liability, of 1.26% - 2.26% (December 31, 2016 – 2% and 0.73% - 2.21%, respectively).

	<b>December 31, 2017</b>	December 31, 2016
	\$	\$
<b>Balance, beginning of year</b>	<b>426,314</b>	446,649
Additions	3,463	-
Additions through acquisitions (note 7)	349,077	-
Liabilities incurred	-	16,626
Abandonments	(193,145)	(28,895)
Revisions / changes in estimates	395,849	(9,624)
Accretion	17,249	3,438
Foreign currency translation	(29,822)	(1,880)
<b>Balance, end of year</b>	<b>968,985</b>	<b>426,314</b>

During the year ended December 31, 2016, the Orphan Well Society abandoned and reclaimed certain wells owned by the Company. As a result, the Company derecognized decommissioning obligation of \$193,145 (2016 - \$28,895) and recorded it as a gain in the Company's consolidated statement of comprehensive loss.

## **13 Loan**

A corporation owned by a party who has a common significant shareholding (the "Lender") advanced to the Company under a loan agreement with a maturity date of August 15, 2013, which was later extended with the same terms and conditions (the "Loan"). The Loan was due on demand December 31, 2016 and 2015. Interest on the Loan is 10% per annum, payable monthly, on the outstanding principal amount.

During year ended December 31, 2017, the Company incurred interest of \$102,492 (December 31, 2016 - \$102,492). This loan was extinguished with proceeds from the Note payable (note 17).

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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The following table summarizes the accounting of the Loan:

	\$
<b>Balance, December 31, 2016 and 2015</b>	<b>1,025,000</b>
Repayment of loan	(1,025,000)
<b>Balance, December 31, 2017</b>	<b>-</b>

## **14 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 (\$201,000 CAD) loan with a maturity date of one year (the “Original Loan”). Pursuant to the Loan Agreement, if it is mutually agreed upon by both parties, the maturity date can be extended by an additional year. During the years ended December 31, 2016, 2015 and 2014, the Lender advanced an additional loan amount of \$75,000 and \$100,000 (the “Advances”), respectively, to the Company under the same terms as the Original Loan. At each maturity date, the Company and the Lender mutually agreed to extend the Original Loan and the Loan advances by an additional year. As at December 31, 2017, the Company has not received demand from the Lender for repayment, and the Company is currently negotiating an extension of the loan with the Lenders. Interest on the loan is 12% per annum, payable monthly, on the outstanding principal amount. Security for the loan consists of a \$150,000 promissory note issued to the Lender 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 of the Original Loan, or any portion outstanding, may have been converted to shares in the Company with a discount of 25% to the market trading price at the time of conversion, at any time during the term. The conversion feature on the Original Loan expired unexercised on December 31, 2014 and the conversion features on the Advances did not receive regulatory approval before the conversion features expired.

The term-extensions in 2015 and 2016 did not result in an extinguishment of the old convertible debt instrument and recognition of a new convertible debt instrument. The original proceeds of the loan were used to continue the Company’s exploration program in Texas. During the year ended December 31, 2017, the Company incurred interest of \$92,164 (December 31, 2016 - \$48,632) on the aggregate amount of \$363,175 owing under the convertible debt.

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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## **15 Demand loan**

On May 12, 2015, the Company entered into a loan agreement (the "Demand Loan") with a corporation owned and controlled by a party who is also a significant shareholder of the Company (the "Lender") for up to an amount of \$150,000. The proceeds of the Demand Loan were used for the continued operation of the Company. The Demand Loan is due on the demand of the Lender and bears interest of 8.00% per annum, compounded monthly. At December 31, 2017, the Company has drawn \$125,500 against the Demand Loan (December 31, 2016 - \$123,000) and has accrued interest of \$28,715 (December 31, 2016 - \$15,299). The Company may repay the Demand Loan in full at any time prior to demand without notice or penalty.

## **16 Short-term loan**

a) During the year ended December 31, 2016, the Company received a short-term loan (the "Short-term Loan") from the Lenders associated with the Loan (note 13) and the Convertible debt (note 14), collectively, the Lenders (the "Lenders") in the maximum available amount of \$350,000. A set-up fee of \$6,000 was charged by the Lenders, and is included in general and administrative expenses. Interest on the Short-term Loan is 10% per annum, compounded monthly. The Short-term Loan matured December 1, 2016. The proceeds of the Short-term Loan were to provide capital for on-going operational and administrative costs of the Company. The Company may re-pay some or all of the outstanding balance of Short-term Loan without notice or penalty.

As security for the total Short-term Loan, if the Short-term Loan is not repaid by the maturity date (December 1, 2016), at the option of the Lenders (the "Option"), the Lenders may acquire a 10% equity investment in PRI (note 6). If the option is exercised by the Lenders, the Lenders have granted the Company the ability to re-acquire the 10% equity investment in PRI for a period of 9 months from Option exercise date insofar as the Short-term Loan is fully repaid. As at December 31, 2017, the Company has not received demand from the Lenders for repayment, nor have they exercised their Option, and the Company negotiated an extension of \$50,000 short-term Loan with the Lenders.

During December 31, 2017 part of the proceeds from the Note Payable (note 17) was used to settle the loan. At December 31, 2017, the total amount outstanding under the Short-term Loan is \$225,000 (December 31, 2016 - \$314,262), and during the year ended December 31, 2017 incurred interest of \$33,363 (December 31, 2016 - \$15,366).

# Emerald Bay Energy Inc.

## Notes to the Consolidated financial statements For the years ended December 31, 2017 and 2016

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The following table summarizes the accounting of the Loan:

	\$
<b>Balance, December 31, 2016</b>	<b>314,262</b>
Repayment of loan	(139,262)
Advanced in 2017	50,000
<b>Balance, December 31, 2017</b>	<b>225,000</b>

- b) As part of the PRI acquisition (Note 7), the Company acquired short term loans. The loans are due to a significant shareholder in the Company. Under the terms of a loan agreement the maturity date was September 15, 2015. These loans are unsecured and non-interest bearing. At December 31, 2017 \$501,800 was outstanding.

### 17 Note Payable and Credit facility

- a) The Company closed a loan agreement (the "Loan Agreement") with a private company (the "Lender"), whereby the Lender issued to the Company a Note payable with the ability to borrow up to \$6,250,000 (the "Note payable"). The Lender is a significant shareholder of the Company. The Note Payable will have an interest free period until October 1, 2017, at which point the Note payable will bear interest at a rate equal to Prime Rate plus 1.5% per annum. The Note payable is payable upon demand by the Lender, and is secured over all of the assets of the Company. The Note Payable was used to repay the Loan (note 13) and the part of the convertible debt (note 16 (a)), with the balance being used for future acquisitions of oil and gas interests in South Texas and Alberta, including in the acquisitions noted in Notes 7 and 10.

At December 31, 2017, the total amount outstanding under the long term Loan is \$6,193,083, (December 31, 2016 - \$Nil), and during the year ended December 31, 2017 incurred interest of \$73,656 (December 31, 2016 - \$Nil).

- b) As part of the PRI acquisition, the Company acquired a credit facility. ). The credit facility is due to a significant shareholder in the Company. The Credit facility may be drawn up to \$4,600,000. At December 31, 2017 the principal balance was \$3,980,263 and unpaid interest is \$454,088. Interest of \$179,634 for the period from date of acquisition to December 31, 2017 was expensed in the statement of comprehensive loss. The Credit facility bears interest at 10%, is unsecured and is due on demand.

### 18 Share capital

- a) Authorized

Unlimited number of common shares with voting rights  
Unlimited number of preferred shares, issuable in series

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements  
For the years ended December 31, 2017 and 2016

b) Issued

	Number of Common Shares	Amount \$
<b>Balance, December 31, 2015</b>	<b>158,610,189</b>	<b>11,447,478</b>
Private placement (i)	40,000,000	800,000
Value of warrants issued pursuant to private placement (i)	-	(521,519)
Share issue costs (i)	-	(6,061)
Expiry of warrants (note 13(c))	-	632,428
Share issuance costs for expired warrants	-	(103,533)
<b>Balance, December 31, 2016</b>	<b>198,610,189</b>	<b>12,248,793</b>
Private placement (ii)	32,000,000	320,000
Value of warrants pursuant to private placement (ii)		(306,498)
Share issue costs (ii)		(2,778)
Private placement (iii)	16,666,667	250,000
Value of warrants pursuant to private placement (iii)		(249,891)
Share issuance costs (iii)		(2,228)
Expiry of warrants (i)		516,232
Share issuance costs for expired warrants (i)		(6,061)
<b>Balance, December 31, 2017</b>	<b>247,276,856</b>	<b>12,767,569</b>

- (i) On February 19, 2016, the Company completed a private placement (the “Private Placement”), issuing 50,000,000 units (the “Unit”). Each Unit was issued at \$0.02 for total proceeds of \$1,000,000, and consists of one common share of the Company and one share purchase warrant (the “Warrant”). As at December 31, 2016, the Company has not collected \$200,000 of the proceeds pursuant to the Private Placement. This amount has been determined to be uncollectible and subsequent to December 31, 2016, 10,000,000 Units were returned to treasury. Each Warrant entitles the holder to purchase one additional common share of the Company at \$0.05 per share, exercisable for 1 year from the original issue date. The Company has allocated \$521,519 of the unit value to warrants (note 17(c)). Pursuant to the Private Placement, the Company incurred \$17,412 in cash share issue costs, of which \$6,061 was allocated to share capital and \$11,351 was allocated to warrants. During the year ended December 31, 2017, the Warrants expired unexercised.
- (ii) On August 23, 2017, the Company completed a private placement (the “Private Placement”), issuing 32,000,000 units (the “Unit”). Each Unit was issued at \$0.01 for total proceeds of \$320,000, and consists of one common share of the Company and one share purchase warrant (the “Warrant”). As at December 31, 2017, the Company had not collected \$17,500 of the proceeds pursuant to the Private Placement. The amount was determined to be collectible. Each Warrant entitled the holder to purchase one additional common share of the Company at \$0.05 per share, exercisable for 1 year from the original issue date. The Company allocated proceeds, net of share issued costs, of \$306,498 of the unit value to warrants (note 18(c)). Pursuant to the Private Placement, the Company incurred \$2,778 in cash share issue costs, which was allocated to the warrants.

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements

For the years ended December 31, 2017 and 2016

- (iii) On December 20, 2017, the Company completed a private placement (the “Private Placement”), issuing 16,666,667 units (the “Unit”). Each Unit was issued at \$0.015 for total proceeds of \$250,000, and consists of one common share of the Company and one share purchase warrant (the “Warrant”). Each Warrant entitled the holder to purchase one additional common share of the Company at \$0.05 per share, exercisable for 1 year from the original issue date. The Company allocated \$249,891 of the unit value to warrants (note 18(c)). Pursuant to the Private Placement, the Company incurred \$2,228 in cash share issue costs, which was allocated to the warrants

## c) Warrants

Warrants to acquire common shares outstanding at December 31, 2017 are as follows:

	Number of warrants issued and exercisable	Amount \$	Weighted average exercise price \$	Weighted average Remaining life (years)
<b>Balance, December 31, 2015</b>	<b>14,938,500</b>	<b>528,898</b>	<b>0.05</b>	<b>0.65</b>
Expiry of share purchase warrants	(14,938,500)	(632,428)	-	-
Share issuance costs for expired warrants	-	103,533	-	-
Share purchase warrants issued (note 18(b)(i))	40,000,000	521,519	0.05	0.14
Share issue costs (note 18(b)(i))	-	(11,351)	-	-
<b>Balance, December 31, 2016</b>	<b>40,000,000</b>	<b>510,171</b>	<b>0.05</b>	<b>0.14</b>
Expiry of share purchase warrants	(40,000,000)	(516,232)	-	-
Share issuance costs for expired warrants	-	6,061	-	-
Share issue costs (note 18(b)(iii))	-	(5,006)	-	-
Share purchase warrant issued (note 18(b)(ii))	32,000,000	311,504	0.05	1.0
Share purchase warrant issued (note 18(b)(iii))	16,666,667	249,891	0.05	1.0
<b>Balance, December 31, 2017</b>	<b>48,666,667</b>	<b>556,389</b>	<b>0.05</b>	<b>1.0</b>

The fair value of the share purchase warrants granted during the year are estimated at the grant date using the Black-Scholes option pricing model and have been credited to warrants within shareholders’ deficit. A weighted average of the assumptions used in the calculation is noted below:

	2017	2016
Risk-free rate	1.37%	0.45%
Expected life	1 year	1 year
Expected volatility	578%	240%
Fair value per warrant	\$0.012	\$0.013

Volatility was determined based on the Company’s historical share prices.



# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements  
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## d) Stock options

The Company established a share option plan (the "Plan") for the benefit of officers, directors, employees and consultants of the Company. Under the Plan, the number of common shares to be reserved and authorized for issuance pursuant to options granted under the Plan cannot exceed 10% of the total number of issued and outstanding shares of the Company. The term, the vesting period and the exercise price are determined at the discretion of the Board of Directors. However, the maximum option term shall not exceed five years.

During the year ended December 31, 2016, there were no stock options granted, cancelled or exercised, and 4,925,000 stock options expired unexercised. The following table summarizes information about the Company's stock options outstanding at December 31, 2017 and 2016:

	December 31, 2017		December 31, 2016	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Stock options, beginning of year	6,700,000	0.07	11,625,000	0.05
Expired	-	-	(4,925,000)	-
Stock options outstanding, end of year	6,700,000	0.05	6,700,000	0.05

The total stock options outstanding at December 31, 2016 and 2017 are as follows:

Exercise price (\$)	Options outstanding	Weighted average remaining term (years)	Weighted average exercise price (\$)
0.05	6,700,000	1.80	0.05

As at December 31, 2017, all stock options have vested and are exercisable.

During the year ended December 31, 2017 and 2016, the Company did not recognized any share-based payment expense.

## e) Per share data

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year. The treasury stock method is used for the calculation of diluted loss per share. Under this method, it is assumed that proceeds from the exercise of dilutive securities are used by the Company to repurchase Company shares at the average price during the year.

All warrants, finder's options and stock options have been excluded from the calculation of diluted shares outstanding as they would be anti-dilutive due to the loss position of the Company.

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements  
For the years ended December 31, 2017 and 2016

## 19 Income tax

The provision for income taxes varies from the amount that would be computed by applying the expected tax rate to income (loss) before income taxes. The principle reasons for differences between such "expected" income tax expense and the amount actually recorded are as follows:

	December 31, 2017	December 31, 2016
	\$	\$
Loss before income taxes	<b>(3,912,710)</b>	(1,069,880)
Statutory income tax rate	<b>27.53%</b>	27.00%
Expected income tax provision	<b>(1,077,102)</b>	(288,868)
Share-based payments	-	-
Investments	-	11,280
Non-deductible expenses	<b>490,651</b>	5,322
Change in tax rates	<b>(201,801)</b>	-
Acquisition of PRI and other	<b>827,236</b>	-
Other	<b>(144,440)</b>	(22,466)
Foreign exchange translation	<b>(45,767)</b>	(32,252)
Other non-taxable accounting gain	-	(7,802)
Change in deferred tax asset not recognized	<b>329,332</b>	334,786
Income tax provision (recovery)	<b>178,109</b>	-

On December 22, 2017, the United States government enacted the US Tax Cuts and Jobs Act ("Act"). The Act includes a range of legislative changes including a reduction of the US federal corporate income tax rate from 32% to 21% effective January 1, 2018. As a result of these legislative changes, the Company is required to revalue its United States deferred income tax assets and liabilities based on the rates they are expected to reverse at in the future, which is 21% for federal tax purposes. The impact for the Company's 2017 financial statements is a reduction in deferred income tax liabilities of \$178,109.

Changes to deferred tax liabilities for December 31, 2017 are comprised of the following:

	December 31, 2017	December 31, 2016
	\$	\$
Property and equipment	<b>(777,464)</b>	-
Non-capital losses	<b>437,439</b>	-
Total	<b>(340,025)</b>	-

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements

For the years ended December 31, 2017 and 2016

Deferred tax assets have not been recognized in respect of the following deductible temporary differences:

	December 31, 2017	December 31, 2016
	\$	\$
Property and equipment	781,557	1,018,628
Flow-through share indemnity liability	89,745	89,745
Finance fees	21,656	10,799
Share issuance costs	4,748	11,570
Scientific research and experimental development	162,716	162,716
Investment tax credits	210,600	210,600
Non-capital losses	2,853,155	2,492,427
Total	4,395,154	3,996,485
Net of deferred tax liability:		
Equity investments	-	(45,768)
Net deferred tax assets	4,395,154	3,950,717
Valuation allowance	(4,395,154)	(3,950,717)
Recognized deferred tax assets	-	-

As at December 31, 2017, the Company has estimated non-capital losses for Canadian income tax purposes that may be carried forward to reduce taxable income in future years. A summary of these tax losses is provided below.

The accumulated non-capital loss carry forwards expire as follows:

2027	\$ 178,670
2028	402,658
2029	1,185,990
2030	1,093,230
2031	1,253,052
2032	1,330,426
2033	958,018
2034	1,139,430
2035	723,338
2036	966,400
2037	1,322,643
	<u>\$ 10,553,855</u>

## 20 Related party transactions

Related party transactions not disclosed elsewhere in these consolidated financial statements are as follows:

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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- a) The following amounts are due from related parties:

During the year ended December 31, 1999, a promissory note was issued by 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 (December 31, 2013 – fair value allowance \$240,789). 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 were to commence on December 31, 2015, and 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. As at December 31, 2017, the officer had not yet paid the initial instalment, and the terms of the payments has been extended to begin on December 31, 2017. The terms of the loan agreement do not provide the Company with recourse to ensure repayment. Thus, the share purchase loan has been presented as a deduction from equity.

- b) Additional related party transactions not disclosed elsewhere in these consolidated financial statements are as follows:

- (i) Aggregate fees of \$Nil (December 31, 2016 - \$22,500) were charged by directors of the Company all of which was recorded in the consolidated statement of comprehensive loss.
- (ii) Aggregate fees of \$72,902 (December 31, 2016 - \$nil) 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 December 31, 2017 was \$359,428 owing to officers of the Company (December 31, 2016 - \$352,412).

### *Key management compensation*

During the year ended December 31, 2017, \$483,040 (December 31, 2016 - \$367,023) in management compensation was incurred. \$365,651 was recognized to the consolidated statement of comprehensive loss and \$117,389 was capitalized to property and equipment in the consolidated statement of financial position.

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements

For the years ended December 31, 2017 and 2016

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## 21 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 committed to monthly payments of \$2,771 for the lease of its office space until November 30, 2016. On December 1, 2016, the Company agreed to continue paying \$2,771 on a month-to-month basis.

On August 1, 2017, the company entered into a new lease agreement with the related party noted above for the lease of office space. Under the new lease agreement, the company committed to monthly payments of \$2,100 on a month-to-month basis.

- b) 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 \$322,624 at December 31, 2017 (December 31, 2016 - \$332,388). The Company has also estimated a potential liability for penalties and taxes in the amounts of \$22,543 (December 31, 2016 - \$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.
- c) During the year ended December 31, 2015, the Company settled a contingent liability totaling \$145,512 with a third party who performed oil field services for the Company. The obligation is secured by a take in kind revenue arrangement from one of its gas wells to and in favor of the third party in case of default. The settlement was fair valued at \$107,912 using Level II valuation techniques with a discount rate of 25%. The Company is required to make 35 monthly payments of \$4,300 starting July 1, 2015 to May 1, 2018 and final installment of \$3,800 to be paid on June 1, 2018. As of December 31, 2017, the Company has not made payment in line with the agreed repayment schedule (December 31, 2016 - \$34,271). Accordingly, the remaining balance of \$87,773 is now considered as due on demand.
- d) A former supplier of the Company submitted a claim against Emerald Bay for \$78,474 USD (\$98,446 CAD) of the amount the supplier is seeking for breach of written agreement for well pumping equipment and services on a well situated in Guadalupe County, Texas in September of 2014. The Company made a counter claim against the supplier asserting no liability based upon

# Emerald Bay Energy Inc.

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defective equipment having been leased by the Plaintiff. As at December 31, 2017 the lawsuit was still in pending status with no expected date of settlement.

## 22 Supplemental cash flow information

	December 31, 2017	December 31, 2016
	\$	\$
The Company had the following non-cash transactions:		
Change in estimates in decommissioning obligations (note 12)	394,735	7,002
Fair value gain (loss) on available-for-sale investment (note 6)	(291,635)	(28,199)
Settlement of other liabilities (note 19)	1,239,262	-
Acquisition of E&E assets (note 10)	1,689,359	-
Acquisition of businesses (note 7)	2,589,180	-
Shareholder deposit	-	800,000
Cash interest paid	-	-

## 23 Financial risk management

The Board of Directors oversees management's 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, available for sale investments, trade and other receivables, accounts payable and accrued liabilities, the shareholder indemnity, the loan, the convertible debt and the demand loan.

Financial instrument	Classification	Carrying value \$	Fair value \$
Cash and cash equivalents	Fair value through profit and loss	124,949	124,949
Short-term investments	Fair value through profit and loss	313,625	313,625
Trade and other receivables	Loans and receivables	219,245	219,245
Investment in partnership	Available for sale	407,677	407,677
Accounts payable and accrued liabilities	Other financial liabilities	5,163,922	5,163,922
Shareholder indemnity	Other financial liabilities	322,624	322,624
Long Term Loan	Other financial liabilities	6,193,083	6,193,083
Convertible debt	Other financial liabilities	363,175	363,175
Credit facility	Other financial liabilities	3,980,263	3,980,263
Short term loan	Other financial liabilities	501,800	501,800

# **Emerald Bay Energy Inc.**

Notes to the Consolidated financial statements

**For the years ended December 31, 2017 and 2016**

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Demand loan	Other financial liabilities	125,500	125,500
Short-term loan	Other financial liabilities	225,000	225,000
Other liabilities	Other financial liabilities	167,028	87,773

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 I are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level II include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level III valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

At December 31, 2017, the Company's cash and cash equivalents and short-term investments have been subject to Level I valuation. The investment in the Partnership is level II.

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 interest 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 interest 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 oil 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 oil and natural gas marketers or others in the event of non-payment.

At December 31, 2017, the Company's trade and other receivables have been aged as follows:

	<b>December 31, 2017</b>	December 31, 2016
<b>Days outstanding</b>	<b>\$</b>	<b>\$</b>
0-30 days	<b>2,079</b>	1,179
31-60 days	<b>19,581</b>	2,185
61-90 days	<b>45,353</b>	1,129
Greater than 90 days	<b>152,232</b>	76,666
Total	<b>219,245</b>	81,159

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements

For the years ended December 31, 2017 and 2016

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Amounts outstanding for more than 90 days are considered past due. During the year ended December 31, 2017, the Company wrote off \$180,421 of trade and other receivables (December 31, 2016 – \$52,869 (recovery)). As at December 31, 2017, a provision for doubtful accounts of \$34,613 has been recorded by the Company (December 31, 2016 - \$48,964).

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 December 31, 2017, the Company's maximum exposure to liquidity risk is the total current liabilities of \$17,529,456 (December 31, 2016 - \$7,047,301) (Note 1).

The current liabilities and commitments are due as follows:

Accounts payable and accrued liabilities	5,163,922	Due within 90 days
Convertible debt (note 14)	363,175	Due on demand
Short term loan (note 16)	501,800	Due on demand
Short term loan (note 16)	225,000	Due on demand
Demand loan (note 15)	125,500	Due on demand
Credit facility (note 17 (b))	3,980,263	Due on demand
Notes payable (note 17 (a))	6,193,083	Due on demand
Shareholder indemnities (note 21(b))	322,624	Due on demand
Short-term loan (note 16)	501,800	Due on demand
Other liabilities (note 20 (c))	167,028	Due on demand

The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity through operations, debt financing, or raising equity 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.



# **Emerald Bay Energy Inc.**

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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 December 31, 2017.

(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 United States 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 United States dollar, including cash and cash equivalents, trade and other receivables and accounts payable and accrued liabilities. As at December 31, 2017, an increase or decrease of 10% to the foreign exchange rate between the United States dollar and the Canadian dollar applied to the average level of United States denominated cash and cash equivalents would have had approximately a \$15,250 (December 31, 2016 - \$16,100) impact on the Company's comprehensive loss for the year.

# Emerald Bay Energy Inc.

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(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 December 31, 2017, all of the Company's debt, including the loan, the convertible debt, the demand loan and the short-term 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 year ended December 31, 2017 or 2016.

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. There has been no change in management's approach to capital management during the year.

## 24 Segmented information

The Company's primary operations are limited to a single industry being the acquisition, exploration for and development of petroleum and natural gas.

Product segmentation is as follows:

Revenue	Oil	Natural Gas	NGL's	Total
December 31, 2017 (\$)	375,762	21,947	37,719	435,458
December 31, 2016 (\$)	-	13,440	-	13,440

# Emerald Bay Energy Inc.

Notes to the Consolidated financial statements

For the years ended December 31, 2017 and 2016

Geographical segmentation is as follows:

	December 31, 2017 (\$)		
	Canada	United States	Total
Petroleum and natural gas sales	31,604	403,854	435,458
Depletion, depreciation and impairment	471,218	1,797,277	2,268,495
Net loss	(3,749,224)	14,623	(3,734,601)
Property and equipment	283,976	5,834,011	6,117,987
Exploration and evaluation assets	-	2,939,539	2,939,532
Investment in Partnership	203,838	203,839	407,677
Total liabilities	4,497,943	13,853,462	18,351,405

  

	December 31, 2016 (\$)		
	Canada	United States	Total
Petroleum and natural gas sales	13,440	-	13,440
Depletion, depreciation and impairment	11,701	310,985	322,686
Net loss	699,700	370,180	1,069,880
Property and equipment	38,958	4,616	43,574
Exploration and evaluation assets	-	1,799,531	1,799,531
Investment in PRI	157,425	157,425	314,850
Investment in Partnership	221,156	221,155	442,311
Total liabilities	4,787,352	2,686,263	7,473,615

## 25 Subsequent events

On January 3, 2018, the Company completed a private placement (the "Private Placement"), issuing 10,000,000 unites (the "Unit"). 2,000,000 of these Units were acquired by an officer of the Corporation and 6,500 were acquired by an insider of the Corporation. Each Unit was issued at \$0.015 for total proceeds of \$150,000, and consists of one common share of the Company and one share purchase warrant (the "Warrant"). Each Warrant entitled the holder to purchase one additional common share of the company at \$0.05 per share, exercisable for 1 year from the original issue date.

On April 27, 2018, the Company completed a private placement (the "Private Placement"), issuing 20,000,000 unites (the "Unit"). 200,000 of these Units were acquired by an officer of the Corporation and 12,000,000 were acquired by an insider of the Corporation. Each Unit was issued at \$0.025 for total proceeds of \$500,000, and consists of one common share of the Company and one share purchase warrant (the "Warrant"). Each Warrant entitled the holder to purchase one additional common share of the company at \$0.05 per share, exercisable for 1 year from the original issue date.