TERRACE RESOURCES INC.

FINANCIAL STATEMENTS

JANUARY 31, 2011 and 2010

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The financial statements of Terrace Resources Inc. are the responsibility of the Company's management. The financial statements are prepared in accordance with Canadian generally accepted accounting principles and reflect management's best estimates and judgment based on information currently available.

Management has developed and is maintaining a system of internal controls to ensure that the Company's assets are safeguarded, transactions are authorized and properly recorded and financial information is reliable.

The Board of Directors is responsible for ensuring management fulfils its responsibilities. The Audit Committee reviews the results of the audit and the annual financial statements prior to their submission to the Board of Directors for approval.

The financial statements as at January 31, 2011 and 2010 and for the years then ended have been audited by Smythe Ratcliffe LLP, Chartered Accountants, and their report outlines the scope of their examination and gives their opinion on the financial statements.

"William David McCartney"

William David McCartney, CEO, CFO

Vancouver, British Columbia
April 6, 2011

SmytheRatcliffe
CHARTERED ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF TERRACE RESOURCES INC.

We have audited the accompanying financial statements of Terrace Resources Inc., which comprise the balance sheets as at January 31, 2011 and 2010, and the statements of operations and 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 Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility
Our responsibility is to express an opinion on these 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

Opinion
In our opinion, the financial statements present fairly, in all material respects, the financial position of Terrace Resources Inc. as at January 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Smythe Ratcliffe LLP

Chartered Accountants

Vancouver, British Columbia
April 6, 2011

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TERRACE RESOURCES INC.
BALANCE SHEETS
AS AT JANUARY 31

	2011	2010
ASSETS		
Current		
Cash	$ 219,701	$ 290,796
HST/GST receivable	1,232	-
	220,933	290,796
Long-Term		
Restricted cash (Note 4)	2,523,771	2,502,262
	$ 2,744,704	$ 2,793,058
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	$ 18,953	$ 6,098
Shareholders' Equity		
Capital Stock (Note 5)	2,880,589	2,880,589
Contributed Surplus (Note 5)	87,950	87,950
Deficit	(242,788)	(181,579)
	2,725,751	2,786,960
	$ 2,744,704	$ 2,793,058

Nature and continuance of operations (Note 1)
Subsequent event (Note 9)

Approved On Behalf of the Board:

"Murray Oliver" Director — Murray Oliver

"William McCartney" Director — William McCartney

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

TERRACE RESOURCES INC.
STATEMENTS OF OPERATIONS AND DEFICIT
FOR THE YEARS ENDED JANUARY 31

	2011	2010
EXPENSES		
Professional fees	$ 44,362	$ 18,739
Transfer agent and filing fees	17,966	13,457
Administration	5,325	-
Business investigation costs	14,828	3,753
Bank charges	237	276
Loss before other item	82,718	36,225
OTHER ITEM		
Interest income	(21,509)	(2,262)
Net loss and comprehensive loss for the year	61,209	33,963
Deficit, beginning of year	181,579	147,616
Deficit, end of year	$ 242,788	$ 181,579
Loss per share	$ 0.005	$ 0.004
Weighted average number of common shares outstanding	12,277,718	9,545,337

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

TERRACE RESOURCES INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JANUARY 31

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the year	$ (61,209)	$ (33,963)
Change in non-cash working capital item		
HST/GST receivable	(1,232)	-
Accounts payable and accrued liabilities	12,855	(51,580)
Net cash outflow from operating activities	(49,586)	(85,543)
CASH FLOWS FROM INVESTING ACTIVITIES		
Restricted cash	(21,509)	(2,502,262)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the issuance of shares	-	2,033,132
Share issue costs	-	(229,933)
Net cash provided by financing activities	-	1,803,199
Change in cash for the year	(71,095)	(784,606)
Cash, beginning of year	290,796	1,075,402
Cash, end of year	$ 219,701	$ 290,796
Cash paid during the year for interest	$ -	$ -
Cash paid during the year for taxes	$ -	$ -

The accompanying notes are an integral part of these financial statements

1. NATURE AND CONTINUANCE OF OPERATIONS

Terrace Resources Inc. (the "Company") was incorporated under the Business Corporations Act (British Columbia) on July 6, 2006. The principal business of the Company is to identify, evaluate and then acquire an interest in a business or assets. The Company is classified as a capital pool corporation ("CPC") as defined in TSX Venture Exchange (the "Exchange") Policy 2.4.

On June 2, 2009, the Company completed a transaction whereby four other CPCs purchased common shares of the Company and distributed them to their respective shareholders upon dissolution. The terms of the transaction, as approved by the Exchange, provided, among other things, that the Company be given 24 months to complete a "Qualifying Transaction" ("QT"), as that term is defined by the Exchange.

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business rather than through a process of forced liquidation.

The Company reported a net loss of $61,209 (2010 - $33,963) for the year ended January 31, 2011 and has an accumulated deficit of $242,788 (2010 - $181,579) as at January 31, 2011. As at January 31, 2011, the Company had working capital of $201,980 (2010 - $284,698) available to meet its liabilities as they become due and continues its evaluation of the potential QT before June 12, 2011. Refer to Note 9.

2. SIGNIFICANT ACCOUNTING POLICIES

Financial instruments

Financial instruments must be classified into one of these five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments are measured in the balance sheet at fair value, except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost.

Subsequent measurement and changes in fair value will depend on their initial classification as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is no longer recognized or impaired, at which time the amounts would be recorded in net income.

The Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 3862.27 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and then lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and
Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Additional disclosure on the measurement of fair value of financial instruments has been provided in Note 6.

Comprehensive income

Comprehensive income is the overall change in the net assets of the Company for a period, other than changes attributable to transactions with shareholders. It is made up of net income and other comprehensive income. Other comprehensive income includes gains or losses, which GAAP requires to be recognized in a period but excluded from net income for that period. The Company has no items of other comprehensive income in any period presented. Therefore, net loss as presented in the Company's statements of operations equals comprehensive loss.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the year. Significant areas requiring the use of management estimates include the determination of the valuation allowance for future tax assets and the estimates of accrued liabilities.

While management believes the estimates used are reasonable, actual results could differ from those estimates and could impact future results of operations and cash flows.

Future income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method of tax allocation, future income tax assets and liabilities are determined based on differences between the financial statements carrying values and their respective income tax basis (temporary differences) and on unclaimed losses carried forward. Future income tax assets and liabilities are measured using the substantially enacted tax rates expected to be in effect when the temporary differences are likely to reverse or when losses are expected to be utilized. The effect on future income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantially assured. The amount of future income tax assets recognized is limited to the amount of the benefit that is more likely than not to be realized.

Loss per share

Basic loss per share is computed using the weighted average number of common shares outstanding during the year. Diluted loss per share amounts are calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares using the treasury stock method. The treasury stock method assumes that proceeds received from the exercise of stock options and warrants are used to repurchase common shares at the prevailing market rate. Diluted loss per share is the same as basic loss per share when the effects of various conversions and exercise of options and warrants would be anti-dilutive.

Shares subject to escrow restrictions are excluded from the weighted average number of shares outstanding unless the release is subject only to the passage of time.

Stock-based compensation

The Company accounts for stock-based compensation using a fair value based method (Black-Scholes option pricing model) with respect to all stock-based payments to directors, employees and non-employees. For directors and employees, the fair value of the options is measured at the date of grant. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is completed or the date the performance commitment is reached or the date at which the equity instruments are granted if they are fully vested and non-forfeitable. The fair value of the options is accrued and charged to operations, with the offset credit to contributed surplus. For directors and employees the fair value is recognized over the vesting period, and for non-employees the fair value is recognized over the related service period. When stock options are exercised, the corresponding fair value is transferred from contributed surplus to capital stock.

3. FUTURE ACCOUNTING POLICIES

International Financial Reporting Standards ("IFRS")

In 2008, the Canadian Accounting Standards Board confirmed that the transition to IFRS from Canadian GAAP will be effective for fiscal years beginning on or after January 1, 2011 for publicly accountable enterprises. The Company will therefore be required to present IFRS financial statements for its April 30, 2011 interim financial statements. The effective date will require the restatement for comparative purposes of amounts reported by the Company for the interim periods and for the year ended January 31, 2011 and earlier where applicable. The Company has determined that the adoption of IFRS will not have a material effect on the Company's financial reporting.

Business Combinations, Non-Controlling Interests and Consolidated Financial Statements

In January 2009, the CICA issued Handbook Sections 1582, "Business Combinations", 1601, "Consolidated Financial Statements", and 1602, "Non-Controlling Interests", which replace Handbook Sections 1581, "Business Combinations", and 1600, "Consolidated Financial Statements". Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under IFRS. Section 1582 is applicable for business combinations with acquisition dates on or after January 1, 2011. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. These sections are applicable to the Company's interim and annual consolidated financial statements for its fiscal year beginning on or after February 1, 2011. Early adoption of this section is permitted and all three sections must be adopted concurrently.

4. RESTRICTED CASH

In connection with the transaction described in Note 1, the Company placed $2,500,000 into a segregated account. Such funds may not be used for general working capital or other purposes prior to the completion of a QT without Exchange approval. If the Company does not complete a QT by June 2, 2011, the Company will be dissolved and the restricted cash, at that particular time, will be distributed to shareholders of the Company, excluding those shareholders whose shares are held in escrow (see Note 5), unless shareholders of the Company vote in favour of an alternative plan. For the year ended January 31, 2011, interest income of $21,509 (2010 - $2,262) was earned. The restricted cash consists of a guaranteed investment certificate with a term of three years maturing on February 11, 2013 and earning interest at 0.85%, 1% and 1.25% each year, respectively.

5. CAPITAL STOCK AND CONTRIBUTED SURPLUS

	Number of Shares	Amount	Contributed Surplus
Balance, January 31, 2009	18,000,000	$ 1,124,510	$ 87,950
Share consolidation	(7,449,499)	-	-
Issued for cash	20,331,320	2,033,132	-
Share issue costs	-	(277,053)	-
Balance, January 31, 2010 and 2011	30,881,821	$ 2,880,589	$ 87,950

On May 29, 2009, the Company consolidated its 18,000,000 outstanding shares into 10,550,501 post-consolidation shares on the basis of a consolidation ratio of 1.70608 pre-consolidation shares for 1 post-consolidation share.

5. CAPITAL STOCK AND CONTRIBUTED SURPLUS (Continued)

On June 2, 2009, the Company:

- issued a total of 20,331,320 post-consolidation common shares at a price of $0.10 per share for aggregate gross proceeds, before transaction costs, of $2,033,132;

- cancelled outstanding stock options to purchase 750,000 pre-consolidation shares exercisable at prices ranging from $0.15 to $0.20 each; and

- exchanged agent options to purchase 400,000 pre-consolidation shares exercisable at $0.10 each for new options to purchase 234,455 post-consolidation common shares exercisable at a price of $0.17 each. The new options expired on July 13, 2009.

Escrow shares

Of the common shares issued, 18,604,103 are subject to an escrow agreement and may not be transferred without the consent of the Exchange. The escrow agreement provides, among other things, that 10% of such shares will be released from escrow upon the completion of a QT, as defined in Exchange Policy 2.4, and that 15% of such shares will be released every six months thereafter. These common shares have been excluded from the weighted average number of shares outstanding, as they are contingently returnable if the Company does not complete a QT.

Stock options

There were no stock option outstanding for the years ended January 31, 2011 and 2010.

6. FINANCIAL INSTRUMENTS

The Company has classified its financial instruments as follows:

- Cash and restricted cash - as held-for-trading; and
- Accounts payable and accrued liabilities - as other financial liabilities.

The Company’s risk exposure and the impact on the Company’s financial instruments are summarized below:

Fair value

The carrying values of cash, restricted cash, and accounts payable and accrued liabilities approximate their fair values because of the short-term maturity of these financial instruments.

Credit risk

Credit risk is the risk of potential loss to the Company if the counterparty to a financial instrument fails to meet its contractual obligations.

The Company's credit risk is primarily attributable to its cash. The Company’s total exposure to credit risk is $2,743,472. The Company manages exposure to credit risk on liquid financial assets through maintaining its cash with major Canadian financial institutions.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in the market prices. Market risk is comprised of three types of risk: interest rate risk, foreign currency risk and other price risk.

6. FINANCIAL INSTRUMENTS (Continued)

Market risk (Continued)

(a) Interest rate risk

The Company's cash and restricted cash earn interest at variable interest rates. Due to the short-term nature of these financial instruments, fluctuations in interest rates will not have a significant impact on the cash flows or fair value of the cash and restricted cash of the Company.

(b) Foreign currency risk

The Company is not exposed to foreign currency fluctuations, as all expenditures incurred are denominated in Canadian dollars.

(c) Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in the market prices, other than those arising from interest rate risk or foreign currency risk. The Company is not exposed to significant other price risk.

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in satisfying financial obligations as they became due. The Company manages liquidity risk through maintaining sufficient cash on hand to meet its obligations as they become due. As at January 31, 2011, the Company was holding cash of $219,701 and working capital of $201,980. The Company holds restricted cash of $2,523,771, which cannot be used prior to the completion of a QT without Exchange approval.

At January 31, 2011, the Company had accrued liabilities of $18,953 (2010 - $6,098) due within three months of the year-end.

7. INCOME TAXES

The reconciliation of income tax attributable to continuing operations computed at the statutory tax rates to income tax expense is:

	2011	2010
Income tax benefit computed at Canadian statutory rates	$ (17,343)	$ (10,147)
Change in timing difference	-	(60,746)
Change in valuation allowance	15,303	63,582
Effect on change in tax rate	2,040	7,311
	$ -	$ -

7. INCOME TAXES (Continued)

The Company has non-capital losses available that may be carried forward to apply against future income for Canadian tax purposes. The losses expire as follows:

2027	$	10,168
2028		29,809
2029		75,177
2030		120,644
2031		145,418
	$	381,216

Significant components of the Company's future tax assets, after applying substantially enacted corporate income tax rates, are as follows:

		2011		2010
Future income tax assets				
Share issuance costs	$	46,401	$	67,454
Non-capital loss carry-forwards		95,304		58,950
		141,705		126,404
Valuation allowance		(141,705)		(126,404)
Net future income tax assets	$	-	$	-

8. MANAGEMENT OF CAPITAL

The Company's capital under management is comprised of shareholders' equity. The Company's objectives when managing capital are to safeguard its ability to continue as a going concern and to pursue a business transaction that meets the requirements of a QT, as established by the Exchange.

In order to facilitate the management of its capital requirements, the Company prepares expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions.

The Company's current capital resources will likely not be sufficient to meet the future plans and operating requirements of a business or asset acquired in connection with a QT. It is therefore likely dependent upon future equity or debt transactions to meet these obligations.

The majority of the Company's capital stock is subject to an escrow agreement that restricts the number of shares that can be transferred without consent from the Exchange.

There were no changes in the Company's approach to capital management during the year and the Company is not subject to externally imposed capital requirements.

9. SUBSEQUENT EVENT

On March 30, 2011, the Company entered into a definitive farm-out agreement to acquire an 87.5% working interest and 65.2% net revenue interest in certain oil and gas leases from Eagle Energy and Development Company, a private company incorporated in Texas. This acquisition is conditional upon Exchange acceptance and approval.

The acquisition will constitute the Company's QT under the policies of the Exchange.