TERRACE ENERGY CORP
(formerly Terrace Resources Inc.)
(the "Company")
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE COMPANY'S FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE YEARS ENDED JANUARY 31, 2012 AND 2011

Date and Subject of this Discussion and Analysis

The following management discussion and analysis of the financial condition and results of operations ("MD&A") of the Company has been prepared by management, in accordance with the requirements of National Instrument of 51-102 as of May 28, 2012 and should be read in conjunction with the audited consolidated financial statements for 2012 and 2011 and the related notes contained therein which have been prepared under International Financial Reporting Standards ("IFRS"). The following should also be read in conjunction with the audited consolidated financial statements and the related MD&A for 2011, and all other disclosure documents of the Company. The audited consolidated financial statements for 2011 were prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"), the reconciliation of which can be found on page 10 of this MD&A. The information contained herein is not a substitute for detailed investigation or analysis on any particular issue. The information provided in this document is not intended to be a comprehensive review of all matters and developments concerning the Company. Additional information relevant to the Company's activities can be found on SEDAR at www.sedar.com and the Company's website at www.terraceenergy.net/.

Cautionary Statement Regarding Forward Looking Statements

This discussion and analysis and the documents referenced in this discussion and analysis contain forward-looking information which may include, but is not limited to, statements with respect to future activities of the Company, the Company's plans for its oil and gas properties, the future financial or operating performance of the Company, its subsidiaries and its projects, the timing and amount of estimated future capital required, operating and capital expenditures, costs and timing of future exploration, government regulation of oil and gas operations, environmental risks, reclamation expenses, title disputes or claims, limitations of insurance coverage, the timing and possible outcome of pending litigation and regulatory matters. These statements relate to analyses and other information that are based on forecasts of future results, estimates of amounts not yet determinable and assumptions of management. Readers are cautioned not to place undue reliance upon these forward looking statements.

Description of Business

Terrace Energy Corp. was incorporated on July 6, 2006 under the Business Corporations Act (British Columbia) and previously named Terrace Resources Inc.

The Company was classified as a capital pool corporation ("CPC") as defined in TSX Venture Exchange (the "Exchange") Policy 2.4. In June 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. At the particular time, the Company was required to place $2,500,000 into a segregated account, which could not be accessed without Exchange approval. These funds, together with accrued interest, were made available for general working capital purposes upon completion of the Company's qualifying transaction in June 2011.

The Company is now classified as a Tier 2 Oil and Gas issuer. Its common shares trade on the Exchange under the symbol "TZR".

The Company is in the business of acquiring, exploring and developing oil and gas properties. The Company has no history of revenues or operating cash flows. The continuing operations of the Company are therefore dependent upon its ability to raise additional capital as required and future profitable operations, neither of which is assured.

The Company's head and principal office is located at Suite 270, 666 Burrard Street, Vancouver, British Columbia V6C 2X8. Its registered and records office is located at 10th Floor, 595 Howe Street, Vancouver, British Columbia V6C 2T5. The Company also maintains an office in Houston, Texas.

The following table lists the Company's principal operating subsidiaries, their jurisdiction of incorporation and its percentage ownership of their voting securities:

Name of subsidiary	Place of Incorporation	Percentage ownership
Terrace US Holdings Inc	USA	100%
Terrace Operating LLC	USA	100%
Terrace Cutlass LLC	USA	100%
Terrace STS LLC	USA	100%

Oil and gas properties

The following is a brief description of the Company's principal oil & gas properties:

Los Patos Gas Unit

During the current year, the Company's wholly-owned subsidiary, Terrace Operating, LLC, and Eagle Energy Development Company entered into a farm-out agreement which entitled the Company to earn up to an 87.5% working interest and 65.1875% net revenue interest in certain oil gas leases covering 320 acres referred to as the "Los Patos Gas Unit" in the Tailfeathers Yegua field in Wharton County Texas, by successfully fracture-stimulating an existing well. The agreement constituted the Company's qualifying transaction.

Work over operations on the Patos Gas Unit #1 well were completed in October 2011. The Company incurred total expenditures of $380,242, which were approximately $49,000 more than the amount estimated in the Company's filing statement dated June 1, 2011.

By funding all costs associated with the re-fracture, stimulation and completion of an existing, primarily gas, well. The Company fulfilled its obligations under the agreement and earned its interests. The well was deemed not successful and since the Company has no further exploration plans at this time it has reduced the carrying value of Los Patos to the approximate current market cost of leasing comparable acreage on similar terms plus the estimated refundable bond. The Company may choose to explore, joint venture, sell, lease or abandon Los Patos in the future.

Cutlass Project

In November, 2011, the Company's wholly owned subsidiary, Terrace Cutlass LLC entered into an agreement with Lightning Oil Company, of San Antonio Texas ("Lightning"), under which the Company was granted the right to earn an 18.75% net revenue interest ("NRI") in certain oil, gas and mineral leases covering 3,395 net acres in the Dimmit and LaSalle Counties, Texas. In February 2012, the Company acquired an additional 5% working interest and 3.75% net revenue interest for US$234,096.

In order to earn the net revenue interests (22.5% in aggregate), the Company agreed to pay 33.33% of all costs, including acreage leases, prospect fees, site preparation and drilling, until the completion of three wells, and thereafter 30% of all cost relating to the lease payments, prospect fees and infrastructure costs covering 1,342 net acres (the "Dimmit County Acreage") plus its share of the drilling costs for the first well on the Dimmit County Acreage. The Company advanced US$2,178,476 in March 2012 representing its estimated share of costs to drill, but not complete, the first well.

The Company has estimated its share of costs to complete and place the first well into production to be approximately US$854,000. The Company is also required to pay its share of the drilling and completion costs of a second well, at an estimated cost to the Company of US$2,333,000 million, in order to earn its interest in the balance of the Dimmit County Acreage.

In addition, after the drilling and technical evaluation of the first well on the Dimmit County Acreage, the Company will have the right to exercise its option to earn a 22.5% net revenue interest in the remaining 2,053 acres (the "LaSalle County Acreage") at a cost of approximately US$739,000, representing its share of lease payments, site preparation and drilling costs of two wells.

Lightning will be the operator of the project with technical and operational input from the Company's technical personnel.

STS Project

In November 2011, the Company's wholly-owned subsidiary, Terrace STS LLC, entered into an agreement with Whittier Energy Company of Houston, Texas ("Whittier") to purchase all of Whittier's leasehold interest in approximately 14,400 gross acres (3875 net acres) in LaSalle and McMullen Counties, Texas. Whittier's interests to be acquired by the Company vary slightly across the acreage, averaging a 26.88% Working Interest and a 20.16% NRI.

The purchase price was US$1.0 million (C$1,014,100) with an effective date of October 1, 2011. The Company's share of the estimated costs to drill and complete an initial test well was US$1,172,853 which was advanced to the project's operator by January 31, 2012. The well was completed and brought into production in February 2012.

The table below summarizes the Company's oil and gas holdings at January 31, 2012:

	Los Patos	STS Olmos	Cutlass	Total
Balance, January 31, 2011	$ -	$ -	$ -	$ -
Acquisition costs	-	1,014,100	376,508	1,390,608
Bond	23,710	-	-	23,710
Exploration and evaluation	380,242	66,422	198,507	645,171
Advances for future exploration	-	1,185,168	-	1,185,168
Impairment charge	(234,564)	-	-	(234,564)
Incidental sales	(5,678)	(7,179)	-	(12,857)
Balance, January 31, 2012	$ 163,710	$ 2,258,511	$ 575,015	$ 2,997,236

Selected Annual Information

The following financial represents selected information of the company for the three most recently completed financial years:

	Year ended January 31 2012	Year ended January 31 2011	Year ended January 31, 2010
Net loss for the year	$ (1,209,346)	$ (61,209)	$ (33,963)
Basic and diluted loss per share	$ (0.03)	$ (0.00)	$ (0.00)
Total assets	$ 5,592,676	$ 2,744,704	$ 2,793,058
Total long-term liabilities	$ -	$ -	$ -
Cash dividends per share	$ -	$ -	$ -

The losses for the year ended January 31, 2012 were primarily for administrative expenses, business investigations, consulting and project investigation costs resulting from the acquisition of a qualifying transaction and the transition to an operating company. Included in the losses in 2012 are non-cash transactions of impairment of oil and gas properties and share-based payments of $234,564 and $277,672 respectively.

The losses for the years ended January 31, 2011 and 2010 were primarily the result of professional and business investigation costs in connection with the investigation and due diligence of prospective qualifying transactions.

Results of Operations

The Company only recently engaged in the business of acquiring, exploring and developing oil and gas properties. It has no history of revenues or cash flows from operations.

The loss for the year ended January 31, 2012 was $1,209,346, compared to a loss of $61,209 for the year ended January 31, 2011. Non cash net deductions for share-based payments and impairment of oil and gas properties were $512,236 in 2012, compared to $nil for the year ended January 31, 2011.

Administrative expenses for the year 2012 were $125,611 compared to $5,562 for the year 2011. The major components of administrative expenses were office expenses, insurance and accounting attributed to the establishment of offices in Texas.

Business investigation costs for the year 2012 were $93,557 compared to $14,828 for the year 2011. The increase in 2012 was due to increased activity in evaluating prospective qualifying transactions. The costs will not continue in the future because the qualifying transaction was completed in June 2011.

Consulting expenses for the year 2012 were $91,511 compared to $nil in 2011. Upon completing the qualifying transaction, the Company engaged David Gibbs to manage its operations, on a fee for services basis. Subsequent to year end Mr. Gibbs was hired as president.

Professional expenses in 2012 were $177,990 compared to $44,362 in 2011. The major component of professional fees include legal fees in Canada associated with the acquisition of the qualifying transaction and audit fees.

Project investigation costs in 2012 were $118,787 compared to $nil in 2011. The Company continues to search for new projects. When a project is determined not to be suitable all cost associated with the investigations are expensed.

Travel expenses were $23,568 in 2012 compared to $nil in 2011. Travel increased due to the commencement of operations in Texas.

Transfer agent and filing fees in 2012 were $69,916 compared to $17,966 in 2011. Transfer agent and filing fees increased due to the completion of a qualifying transaction and increased market activity associated with the new share issues.

Fourth Quarter

The loss for the three months ended January 31, 2012 was $538,419 compared to a loss of $14,429 for the three months ended January 31, 2011. Non cash net deductions for share-based payments and impairment of oil and gas properties were $330,442 in 2012, compared to $nil for the three months ended January 31, 2011.

Administrative, professional, consulting project investigation and transfer and filing expenses were the major components of loss in the fourth quarter as the Company transitioned to an operating company in 2012 from a capital pool company in 2011.

Summary of Quarterly Results

The results of the Company's most recent eight quarters are set out below:

	January 31, 2012	October 31, 2011	July 31, 2011	April 30, 2011
Revenue	$ -	$ -	$ -	$ -
Net income (loss)	(561,886)[1]	(251,308)[2]	(251,065)[3]	(145,087)
Oil and gas properties	2,997,236	306,959	-	-
Total assets	5,592,676	3,332,630	3,425,756	2,636,833
Income (loss) per share	(0.01)	(0.01)	(0.01)	(0.00)

	January 31, 2011	October 31, 2010	July 31, 2010	April 30, 2010
Revenue	$ -	$ -	$ -	$ -
Net income (loss)	(14,429)	4,026	(26,046)	(24,760)
Oil and gas properties	-	-	-	-
Total assets	2,744,704	2,743,031	2,736,821	2,766,226
Income (loss) per share	(0.00)	0.00	(0.01)	(0.00)

Notes:

1) The Company's loss during this period includes non-cash deductions of $95,878 for share-based payments and $234,564 for impairment of oil and gas properties.
2) The Company's loss includes expenses incurred in connection with the Company's new business after the completion of its qualifying transaction in June 2011.
3) The Company's loss during this period includes non-cash deductions of $173,699 for share-based payments.

Fluctuations in reported earnings during the quarters are primarily due to changes in share-based payments, professional fees, business investigation costs and costs associated with its new business after completion of the Company's qualifying transaction in June 2011. There was no impact on quarterly results transitioning from Canadian Generally Accepted Accounting Principles to International Financial Reporting Standards ("IFRS").

Financial Condition, Liquidity and Capital Resources

As at January 31, 2012, the Company had cash of $2,590,292 and accounts payable and accrued liabilities of $167,113 due within three months of the year-end.

In June 2011, the Company completed a private placement of 10 million units at $0.09 per unit for gross proceeds of $900,000, and in December 2011 the Company completed a private placement of 9 million common shares at $0.25 for gross proceeds of $2,250,000.

During the year, the Company also received $537,750 from the issuance of 3,037,500 common shares on the exercise of share purchase warrants and options.

In May 2012, the Company received $10,000,000 from the issuance of 10 million common shares from a private placement.

The proceeds from these placements will be used, together with the Company's existing working capital and previously restricted cash, to fund the development of the Company's oil and gas properties and for general working capital purposes.

As of the date of this report, the Company has no significant commitments or restrictions on its cash except as described herein (see "Description of Business"). The Company has not pledged any of its assets as security for loans, or otherwise, and is not subject to any debt or other covenants. Management of the Company believes it has sufficient capital to meet its financial obligations over the next twelve months. However, additional financing may be required to fund the future development of its oil and gas properties. Although the Company has been successful with securing capital in the past, there is no assurance that it will secure necessary capital in the future.

Off Balance Sheet Arrangements

There are no off-balance sheet arrangements to which the Company is committed.

Key Management Personnel Compensation

During the year, the Company:

a) Paid or accrued $91,511 (2011 - $nil) for consulting fees, $19,989 (2011 - $nil) for project investigation costs, $20,025 (2011 - $nil) for business investigation costs to Dave Gibbs, a director of the Company, and fees of $40,402 were included in mineral properties;

b) Paid or accrued $119,451 (2011 - $18,592) for legal fees and $54,902 (2011- $nil) for share issue costs to a law firm of which Paul Visosky, the corporate secretary of the Company is a principal;

c) Paid or accrued $3,000 (2011 - $nil) for accounting fees to a firm where Scott Davis, an officer of the Company is a partner;

d) Paid or accrued $11,000 (2011 - $12,000) for accounting fees to Jennie Choboter, a former officer of the Company.

The compensation paid to key management personnel was $311,661 (2011 - $12,000), which included short term benefits of $33,989 (2011 - $12,000) and share-based payments of $277,672 (2011 - $nil). Share-based payments are the fair value of the options granted to directors and other key management personnel.

Critical Accounting Estimates and Policies

Set out below are the Company's critical accounting policies and estimates:

The preparation of the financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported expenses during the period. Actual results could differ from these estimates and, as such, estimates and underlying assumptions are reviewed on an ongoing basis. Revisions are recognized in the period in which the estimates are revised and in any future period affected.

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the end of the reporting period that could result in a material adjustment to the carrying amounts of assets and liabilities in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

i) The inputs used in calculating the fair value for stock-based compensation expense included in operations.
ii) The inputs used in calculating the fair value of warrants included in units issued in private placements.
iii) The valuation of shares issued in non-cash transactions.
iv) The recoverability of amounts recorded as oil and gas properties.

Financial instruments

All financial instruments are classified as one of the following: held-to-maturity, loans and receivables, fair value through profit or loss ("FVTPL"), available-for-sale or other financial liabilities. Financial assets and liabilities at FVTPL are measured at fair value with gains and losses recognized in income or loss. Financial assets held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method. Available-for-sale instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) and reported in shareholders' equity.

Transaction costs that are directly attributable to the acquisition or issue of financial instruments that are classified as other than FVTPL, which are expensed as incurred, are included in the initial carrying value of such instruments.

Foreign currency translation

The Company's subsidiaries are integrated foreign operations and are translated into Canadian dollars using the temporal method. Monetary items are translated at the exchange rate in effect at the statement of financial position date and non-monetary items are translated at historical exchange rates. Income and expense items are translated at rates approximating those in effect at the time of the transactions. Translation gains and losses are reflected in the results of operations.

Oil and gas properties

Pre-exploration ("Project Investigation Costs") expenditures

Expenditures made by the Company before acquiring the legal right to explore in a specific area do not meet the definition of an asset and therefore are expensed by the Company as incurred.

Exploration and evaluation expenditures

Costs incurred once the legal right to explore has been acquired are capitalized as exploration and evaluation assets. These assets include, but are not limited to, exploration license expenditures, leasehold property acquisition costs, evaluation costs, including drilling costs directly attributable to an identifiable well and directly attributable general and administrative costs. These costs are accumulated in cost centers by property and are not subject to depletion until technical feasibility and commercial viability has been determined.

Exploration and evaluation assets are assessed for impairment when facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proved and probable reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proved and probable reserves have been discovered. Upon determination, proved and probable reserves, exploration and evaluation assets attributable to these reserves are tested for impairment and reclassified from exploration and evaluation assets to oil and gas properties.

Development and production costs

Items of property and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped in cash-generating units ("CGU") for impairment testing. A CGU's recoverable amount is higher of its fair value less costs to sell and its value in use. Where the carrying amount of a CGU exceeds its recoverable amount, the asset group is considered impaired and is written down to its recoverable amount.

Gains and losses on disposal of an item of property and equipment, including oil and gas properties, are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized within net loss.

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 gas properties only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in net income or loss as incurred. Such capitalized oil and gas properties 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 a replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in net income or loss as incurred.

Asset retirement obligations

The Company recognizes the fair value of a provision for an asset retirement obligation in the year in which it is incurred when a reasonable estimate of fair value can be made. The carrying amount of the related long-lived asset is increased by the same amount as the liability. Changes in the liability for an asset retirement obligation due to the passage of time will be measured by applying an interest method of allocation. The amount will be recognized as an increase in the liability and an accretion expense in the statement of operations. Changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows are recognized as an increase or a decrease to the carrying amount of the liability and the related long-lived asset.

As of January 31, 2012 and 2011, the Company does not have any asset retirement obligations.

Share-based payments

Share-based payments to employees are measured at the fair value of the instruments issued and amortized over the vesting periods. Share-based payments to non-employees are measured at the fair value of the goods or services received or the fair value of the equity instruments issued, if it is determined the fair value of the goods or services cannot be reliably measured, and are recorded at the date the goods or services are received. The offset to the recorded cost is to share-based payments reserve. Consideration received on the exercise of stock options is recorded as capital stock and the related amount originally recorded in share-based payments reserve is transferred to capital stock. Upon expiry, related fair value calculated is transferred from share-based payments reserve to deficit.

Income taxes

The Company uses the asset and liability method for accounting for income taxes. Under this method of tax allocation, deferred income tax assets and liabilities are determined based on differences between the financial statement carrying values and their respective income tax basis (temporary differences). Deferred income tax assets and liabilities are measured using the tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on deferred 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 deferred income tax assets recognized is limited to the amount of the benefit that is more likely than not to be realized.

Capital stock

Proceeds from the issue of units is allocated between common shares and share purchase warrants on a relative fair value basis, based on the fair value of common shares being the market value on the date of announcement of the placement and the value of share purchase warrants as determined using the Black Scholes option pricing model.

Basic and diluted loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year. The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is calculated presuming the exercise of outstanding options, warrants and similar instruments.

It assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the year. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

Shares held in escrow, other than where their release is subject to the passage of time, are not included in the calculation of the weighted average number of common shares outstanding.

Revenue recognition

Interest income is recognized as earned.

New accounting pronouncements

Certain new accounting standards and interpretations have been published that are not mandatory for the year ended January 31, 2012:

IFRS 9 *Financial Instruments* is effective for accounting periods commencing on or after January 1, 2015.

Amendments to IFRS 7 *Financial Instruments: Disclosures* are effective for annual periods beginning on or after July 1, 2011 and introduce enhanced disclosure around transfer of financial assets and associated risks. These amendments are not anticipated to impact the disclosures made by the Company.

Amendments to IAS 1 *Presentation of Financial Statements* (effective for annual periods beginning on or after July 1, 2012) require that elements of other comprehensive income that may subsequently be reclassified through profit and loss be differentiated from those items that will not be reclassified.

IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, and consequential revisions to IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* (all effective January 1, 2013) provide revised guidance on the accounting treatment and associated disclosure requirements for joint arrangements and associates, and a revised definition of "control" for identifying entities that are to be consolidated.

IFRS 13 *Fair Value Measurement* (effective January 1, 2013) provides new guidance on fair value measurement and disclosure requirements.

The Company is currently evaluating the impact of these new and amended standards on its consolidated financial statements.

International Financial Reporting Standards ("IFRS")

The Company adopted IFRS on February 1, 2011 with a transition date of February 1, 2010. Under IFRS 1 *First-time Adoption of International Financial Reporting Standards*, the IFRS are applied retrospectively at the transition date with all adjustments to assets and liabilities as stated under GAAP taken to deficit unless certain exemptions are applied.

The Company elected to take the following IFRS 1 transition elections and accounting policy choices:

Business combinations

The Company has elected to not apply IFRS 3 Business Combinations to business combinations that occurred before the date of transition to IFRS, which is an election permitted on first-time adoption of IFRS. IFRS 3 is applicable for business combinations occurring on or after February 1, 2010.

Share-based payments

IFRS 1 allows a first-time adopter to not apply IFRS 2 *Share-based Payment* to share-based payments granted after November 7, 2002 that vested before the later of the date of transition to IFRS and January 1, 2005. The Company has elected not to apply IFRS 2 to awards that vested prior to February 1, 2010.

Under Canadian GAAP, amounts in contributed surplus relating to expired share-based payments remain there indefinitely. The Company has elected to change its accounting policy to transfer the value of the unexercised expired options to deficit as allowed under IFRS.

IFRS employs a conceptual framework that is similar to Canadian GAAP. The following represents the reconciliations from Canadian GAAP to IFRS for the respective periods noted for equity, earnings and comprehensive loss. The effects on the statements of cash flows would not have been material and, therefore, have not been presented.

The February 1, 2010 Canadian GAAP consolidated statement of financial position has been reconciled to IFRS as follows:

	February 1, 2010		
	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Current			
Cash	$ 290,796	$ -	$ 290,796
Receivables	-	-	-
	290,796	-	290,796
Long-Term			
Restricted cash	2,502,262	-	2,502,262
	$ 2,793,058	$ -	$ 2,793,058
Liabilities			
Current			
Accounts payable and accrued liabilities	$ 6,098	$ -	$ 6,098
Shareholders' Equity			
Capital stock	2,880,589	-	2,880,589
Reserves	87,950	(87,950)	-
Deficit	(181,579)	87,950	(93,629)
			2,786,960
	2,786,960	-	2,786,960
	$ 2,793,058	$ -	$ 2,793,058

The January 31, 2011 Canadian GAAP statement of financial position has been reconciled to IFRS as follows:

	January 31, 2011		
	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Current			
Cash	$ 219,701	$ -	$ 219,701
Receivables	1,232	-	1,232
	220,933	-	220,933
Long-Term			
Restricted cash	2,523,771	-	2,523,771
	$ 2,744,704	$ -	$ 2,744,704
Liabilities			
Current			
Accounts payable and accrued liabilities	$ 18,953	$ -	$ 18,953
Shareholders' Equity			
Capital stock	2,880,589	-	2,880,589
Reserves	87,950	(87,950)	-
Deficit	(242,788)	87,950	(154,838)
	2,725,751	-	2,725,751
	$ 2,744,704	$ -	$ 2,744,704

The statement of operations and comprehensive loss under Canadian GAAP for the year ended January 31, 2011 has been reconciled to IFRS as follows:

	January 31, 2011		
	Canadian GAAP	Effect of transition to IFRS	IFRS
Expenses			
Administrative	$ 5,562	$ -	$ 5,562
Business investigation costs	14,828	-	14,828
Professional fees	44,362	-	44,362
Transfer agent and filing fees	17,966	-	17,966
Loss before other item	82,718	-	82,718
Other Item			
Interest income	(21,509)	-	(21,509)
Net Loss and Comprehensive Loss	$ 61,209	$ -	$ 61,209

<u>Critical Risk Factors</u>

The exploration and development of oil and gas properties involves certain significant risks not within the control of management. Critical risks factors affecting the prospects of the Company include, but are not limited to, the following:

<u>Exploration, Development and Production Risks</u>
Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on future exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. The Company, through its subsidiaries, has the right to earn working interests in various oil & gas properties described herein. To earn such interests the Company must incur certain specified expenditures to evaluate and complete a number of prospective wells capable of producing oil and gas in paying quantities. No assurance can be given that the Company will be successful in completing a well capable of producing oil and gas. The long-term commercial success of the Company depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Without the continual addition of new reserves, any existing reserves the Company may have at any particular time and the associated production if any therefrom will decline over time as the reserves are exploited. A future increase in the Company's reserves will depend not only on its ability to explore and develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. No assurance can be given that the Company will be able to continue to locate satisfactory properties for acquisition or participation. Exploration and development activities may be delayed or adversely affected by factors outside the control of the Company including adverse climatic and geographic conditions, labour disputes, compliance with governmental requirements, shortage or delays in installing and commissioning plant and equipment or import or customs delays. Drilling may involve unprofitable efforts, not only with respect to dry wells, but also with respect to wells, though yielding some oil or gas, are not sufficiently productive to justify commercial development or cover operating and other costs. Oil and natural gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts, cratering, sour gas releases and spills,

each of which could result in substantial damage to oil and natural gas wells, production facilities, other property and the environment or in personal injury.

Additional Funding Requirements
Terrace has no history of production or profitability and its financial resources may not be sufficient to fund its on going activities at all times. From time to time, the Company will require additional financing to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause the Company to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. Any additional financing is likely to involve the issuance of securities which could be substantially dilutive.

No Assurance of Title
Title to oil and gas interests is often not capable of conclusive determination without incurring substantial expense. The nature of the oil and gas leasing and title regime in the U.S. is such that interests in tracts of acreage may be represented by many leases and other agreements affecting oil and gas rights and access and obtaining absolute confirmation of chain of title would be time consuming and expensive. While the Company will conduct a title review of a particular area prior to commencement of drilling there can be no assurance of title. Title may be subject to unregistered liens and other defects which, if affecting a core area, could have a material adverse effect on the Company, its financial condition, results of operations and prospects.

Permits and Licenses
The activities of the Company are subject to government approvals, various laws governing prospecting, development, land resumptions, production taxes, labour standards and occupational health, safety, toxic substances and other matters, including issues affecting local native populations. Although the Company believes its planned development work is in accordance with all applicable rules and regulations, no assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail production or development. Amendments to current laws and regulations governing operations and activities of exploration and quarrying, or more stringent implementation thereof, could have a material adverse impact on the business, operations and financial performance of the Company. Further, the exploration and development permits and licenses that have and may be issued in respect of each project may be subject to conditions which, if not satisfied, may lead to the revocation of such permits and licenses. In the event of revocation, the value of the Company's investments in such projects may decline.

Reserve Estimates
No current reserves have been estimated in respect of the Company's oil & gas properties.. There are numerous uncertainties inherent in estimating quantities of oil, natural gas and natural gas liquids reserves and resources and associated cash flows, including many factors beyond the Company's control. In general, estimates of economically recoverable oil and natural gas reserves and the future net cash flows from them are based upon a number of variable factors and assumptions, such as historical production from the properties, production rates, ultimate reserve recovery, timing and amount of capital expenditures, marketability of oil and natural gas, royalty rates, the assumed effects of regulation by governmental agencies and future operating costs, all of which may vary from actual results. The Company's actual production, revenues, taxes and development and operating expenditures with respect to its reserves will vary from estimates thereof and such variations could be material.

Prices and Markets for Oil and Natural Gas
Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which will be beyond the control of the Company. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices or natural gas prices, leading to a reduction in the volume of the Company's oil and gas reserves. The Company

might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. Prices for oil and gas are subject to large fluctuations in response to relatively minor changes in the supply of and demand for oil and gas, market uncertainty and a variety of additional factors beyond the control of the Company. These factors include economic conditions, in the United States and Canada, the actions of OPEC, governmental regulation, political stability in the Middle East and elsewhere, the foreign supply of oil and gas, risks of supply disruption, the price of foreign imports and the availability of alternative fuel sources. Any substantial and extended decline in the price of oil and gas would have an adverse effect on the Company's carrying value of its reserves, borrowing capacity, revenues, profitability and cash flows from operations and may have a material adverse effect on the Company's business, financial condition, results of operations and prospects.
Uninsurable Risks

<u>Lack of Adequate Insurance</u>
In the course of exploration, development and production of mineral properties, certain risks, and in particular, unexpected or unusual geological operating conditions including rock bursts, cave-ins, fires, flooding and earthquakes may occur. It is not always possible to fully insure against such risks and the Company may decide not to take out insurance against such risks as a result of high premiums or other reasons. Should such liabilities arise, they could reduce or eliminate any future profitability and result in increasing costs and a decline in the value of the securities of the Company.

<u>Competition</u>
The oil and gas industry is highly competitive. The Company's competitors for the acquisition, exploration, production and development of oil and natural gas properties, and for capital to finance such activities will include companies that have greater financial and personal resources available to them than the Company.

<u>Risks Associated with Joint Operating Agreements</u>
The development of the Company's oil & gas properties is governed by a various joint operating agreements. The existence or occurrence of a disagreement or dispute with or among the other parties to such agreementa could have a material adverse impact on the Company's profitability or the viability of its interests , which could have a material adverse impact on the Company's business prospects, results of operations and financial condition.

<u>Environmental Risks</u>
All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and provincial and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations or prevent operations all together. Government approvals and permits are currently, and may in the future be, required in connection with the Company's operations, which could potentially make operations expensive or prohibit them altogether. To the extent such future approvals are required and not obtained, the Company may be curtailed or prohibited from proceeding with planned exploration or development of the Properties or from commencing production.

<u>Availability of Drilling Equipment and Access Restrictions</u>

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Company and may delay exploration and development activities.

Current Global Financial Conditions

Current global financial conditions have been subject to increased volatility and numerous financial institutions have either gone into bankruptcy or have had to be rescued by governmental authorities. Access to public financing has been negatively impacted by both sub-prime mortgages and the liquidity crisis affecting the asset-backed commercial paper market. These factors may impact the ability of the Company to obtain equity or debt financing in the future and, if obtained, on terms favourable to the Company. If these increased levels of volatility and market turmoil continue, the Company's operations could be adversely impacted and the value and the price of the Company's shares could continue to be adversely affected.

Geo Political Risks

The marketability and price of oil and natural gas that may be acquired or discovered by the Company is and will continue to be affected by political events throughout the world that cause disruptions in the supply of oil. Conflicts, or conversely peaceful developments, arising in the Middle East, and other areas of the world, have a significant impact on the price of oil and natural gas. Any particular event could result in a material decline in prices and therefore result in a reduction of the Company's net production revenue.

Transportation Costs

Disruption in or increased costs of transportation services could make oil and natural gas a less competitive source of energy or could make the Company's oil and natural gas less competitive than other sources. The industry depends on rail, trucking, ocean-going vessels, pipeline facilities, and barge transportation to deliver shipments, and transportation costs are a significant component of the total cost of supplying oil and natural gas. Disruptions of these transportation services because of weather related problems, strikes, lockouts, delays or other events could temporarily impair the ability to supply oil and natural gas to customers and may result in lost sales. In addition, increases in transportation costs, or changes in transportation costs for oil and natural gas produced by competitors, could adversely affect profitability. To the extent such increases are sustained, the Company could experience losses and may decide to discontinue certain operations forcing the Company to incur closure and/or care and maintenance costs, as the case may be. Additionally, lack of access to transportation may hinder the expansion of production at some of the Company's properties and the Company may be required to use more expensive transportation alternatives.

Pipeline Capacity

Although pipeline expansions are ongoing, the availability of sufficient pipeline capacity continues to affect the oil and natural gas industry and limit the ability to produce and to market natural gas production. In addition, the prorationing of capacity on the inter-state pipeline systems also continues to affect the ability to export oil and natural gas.

Reliance on Key Individuals

The Company's success depends to a certain degree upon certain key members of the management. It is expected that these individuals will be a significant factor in the Company's growth and success. The loss of the service of members of the management and certain key employees could have a material adverse effect on the Company.

Conflicts of Interest

Certain of the Company's directors are also directors, officers or shareholders of other companies that are engaged in the business of acquiring, developing and exploiting natural resource properties. Such associations may give rise to conflicts of interest from time to time. Such a conflict poses the risk that the Company may enter into a transaction on terms which place the Company in a worse position than if no conflict existed. The directors are required by law to act honestly and in good faith with a view to the best interest of the Company and to disclose any interest which they may have in any project or opportunity of the Company. However, each director has similar obligations to other companies for which such director serves as an officer or director. If a conflict of interest arises at a meeting of the board of directors, any director in a conflict is required disclose his interest and abstain from voting on such matter. In determining whether or not the Company will participate in any project or opportunity, the board of directors will primarily consider the degree of risk to which the Company may be exposed and its financial position at that time.

Financial Instruments

The Company has classified its financial instruments as follows:

- Cash and restricted cash - as FVTPL; 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 due to 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 and receivables. The Company manages exposure to credit risk on liquid financial assets through maintaining its cash with major Canadian financial institutions, for which management believes the risk of loss to be minimal.

Market risk

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

(i) Interest rate risk

To the extent that payments made or received on the Company's monetary assets and liabilities are affected by changes in prevailing market interest rates, the Company is exposed to interest rate cash flow risk.

To the extent that changes in prevailing market interest rates differ from the interest rates in the Company's monetary assets and liabilities, the Company is exposed to interest rate price risk.

The Company's exposure to interest rate risk is minimal.

(ii) Foreign currency risk

The Company's principal asset is located in the United States. As at the date of this report, the majority of the Company's cash was held in Canadian dollars and was therefore subject to fluctuation against the United States dollar. Based on the balances as at January 31, 2012, if the US dollar had weakened (strengthened) against the Canadian dollar, with all other variables held constant, by 1%, net loss would be approximately $1,000. There would be no effect on other comprehensive loss. The Company does not use derivatives or similar instruments to manage currency risk.

(iii) Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to 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 become due. The Company manages liquidity risk through maintaining sufficient cash on hand to meet its obligations as they become due. As at January 31, 2012, the Company had cash of $2,590,292 and accounts payable and accrued liabilities of $167,113 due within three months of the period-end.

Shareholder's Equity and Outstanding Share Data

The authorized share capital of the Company consists of an unlimited number of common shares.

As of May 28, 2012, the Company had the following outstanding:

- 62,919,321 common shares

- Stock options:

Number of options	Number of options exercisable	Exercise price	Weighted average remaining contractual life (years)
1,800,000	1,800,000	$ 0.12	4.39
250,000	62,500	0.19	4.45
250,000	25,000	0.21	4.60
250,000	25,000	0.19	4.72
100,000	20,000	0.53	4.82
250,000	25,000	0.67	4.88
2,900,000	1,957,500		4.50

- Warrants

Number of warrants	Exercise price	Expiry date
7,112,500	0.18	June 21, 2016

Internal Controls Over Financial Reporting

Changes in Internal Control over Financial Reporting ("ICFR")
In connection with National Instrument 52-109, Certification of Disclosure in Issuer's Annual and Interim Filings ("NI 52-109") adopted in December 2008 by each of the securities commissions across Canada, the Chief Executive Officer and Chief Financial Officer of the Company will file a Venture Issuer Basic Certificate with respect to financial information contained in the unaudited interim financial statements and the audited annual financial statements and respective accompanying Management's Discussion and Analysis. The Venture Issue Basic Certification does not include representations relating to the establishment and maintenance of disclosure controls and procedures and internal control over financial reporting, as defined in NI52-109.

Proposed Transactions

There are no proposed transactions that have not been disclosed herein.

Contingencies

There are no contingent liabilities.

Management's Responsibility For Financial Statements

The information provided in this report, including the financial statements, is the responsibility of management. In the preparation of these statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgments and have been properly reflected in the financial statements.

Other MD&A Requirements

Additional disclosure of the Company's technical reports, material change reports, news releases and other information can be obtained on SEDAR at www.sedar.com.

Directors and Officers

Eric Boehnke	Director and CEO
David Gibbs	Director and President
Dan Carriere	Director
Murray Oliver	Director
William McCartney	Director
Scott Davis	CFO
Paul Visosky	Secretary
Ken Shannon	Assistant Secretary

Contact Person

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