TERRACE ENERGY CORP.
CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(Unaudited and Expressed in United States Dollars)

FOR THE SIX AND THREE MONTHS ENDED JULY 31, 2013 and 2012

TERRACE ENERGY CORP.

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these interim financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Vancouver, Canada

September 27, 2013

TERRACE ENERGY CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION
UNAUDITED – PREPARED BY MANAGEMENT
(Expressed in United States Dollars)

		July 31, 2013		January 31, 2013
ASSETS				
Current assets				
Cash	$	17,157,777	$	1,673,449
Accounts receivable (Note 11)		531,470		1,327,511
Prepaids		26,673		50,029
Total current assets		17,715,920		3,050,989
Non-current assets				
Operators bond		25,000		25,000
Investment in partnership (Note 4)		12,900,434		-
Advances for future exploration (Note 5)		1,890,819		459,008
Exploration and evaluation assets (Note 6)		10,878,981		6,737,039
Property and equipment (Note 7)		9,615,819		6,047,528
Total assets	$	53,026,973	$	16,319,564
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Accounts payable and accrued liabilities (Notes 11 and 14)	$	1,146,892	$	571,585
Non-current liabilities				
Convertible notes (Note 8)		34,545,253		-
Decommissioning obligations (Note 9)		8,016		8,016
Total liabilities		35,700,161		579,601
Shareholders' equity				
Capital stock (Note 10)		16,117,713		15,977,713
Convertible notes – equity component (Note 8)		2,912,745		-
Stock options reserve (Note 10)		802,843		638,649
Warrants reserve (Note 10)		255,342		255,342
Translation reserve (Note 2)		(197,545)		396,149
Deficit		(2,564,286)		(1,527,890)
Total shareholders' equity		17,326,812		15,739,963
Total liabilities and shareholders' equity	$	53,026,973	$	16,319,564

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

TERRACE ENERGY CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
UNAUDITED – PREPARED BY MANAGEMENT
(Expressed in United States Dollars)

	For the six months ended July 31, 2013	For the six months ended July 31, 2012	For the three months ended July 31, 2013	For the three months ended July 31, 2012
REVENUE				
Oil and gas sales	$ 1,621,660	$ 759,958	$ 765,649	$ 202,868
DIRECT OPERATING EXPENSES				
Production and operating	175,331	79,539	26,882	48,241
Royalties	73,508	41,285	33,628	7,141
Depreciation, depletion and accretion	493,531	18,468	220,773	12,949
Operating income	879,290	620,666	484,366	134,537
Equity income in partnership	35,909	-	35,909	-
	915,199	620,666	520,275	134,537
GENERAL AND ADMINSTRATIVE EXPENSES				
Administrative	344,105	326,083	202,152	211,536
Foreign exchange gain	(761,051)	(92,687)	(794,843)	(61,644)
Impairment (recovery) of assets	73,983	-	(30,167)	-
Interest expense (Note 8)	1,033,125	-	833,938	-
Interest income	-	(12,598)	-	(12,598)
Investor relations	190,805	69,648	48,677	38,692
Professional	166,268	122,568	93,999	81,110
Project investigation costs	12,570	5,094	-	-
Salaries and benefits (Note 14)	404,609	-	301,083	-
Share-based payments (Notes 10 and 14)	304,194	146,020	231,077	70,289
Transfer agent and filing fees	53,500	30,918	24,482	18,306
Travel	129,487	53,623	108,445	29,602
	1,951,595	648,669	1,018,843	375,293
Net loss for the period	$ (1,036,396)	$ (28,003)	$ (498,568)	$ (240,756)
Basic and diluted loss per share	$ (0.02)	$ (0.00)	$ (0.01)	$ (0.00)
Weighted average number of shares outstanding	63,076,393	57,578,437	63,083,234	62,289,321

Comprehensive loss				
Net loss for the period	$ (1,036,396)	$ (28,003)	$ (498,568)	$ (240,756)
Cumulative translation adjustment	(593,694)	(543,439)	(363,978)	(567,387)
Comprehensive loss for the period	$ (1,630,090)	$ (571,442)	$ (862,546)	$ (808,143)

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

TERRACE ENERGY CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
UNAUDITED – PREPARED BY MANAGEMENT
(Expressed in United States Dollars)

	Capital Stock							
	Shares	Amount	Convertible Notes - Equity Component	Stock Options Reserve	Warrants Reserve	Translation Reserve	Deficit	Total Shareholders' Equity
Balance – January 31, 2012	**52,919,321**	**$ 5,970,906**	**$ -**	**$ 259,081**	**$ 255,342**	**$ 299,995**	**$ (1,406,168)**	**$ 5,379,156**
Private placement	10,000,000	10,024,019	-	-	-	-	-	10,024,019
Share issue costs	-	(48,787)	-	-	-	-	-	(48,787)
Share-based payments	-	-	-	146,020	-	-	-	146,020
Exercise of options	150,000	18,043	-	-	-	-	-	18,043
Fair value of options exercises	-	13,532	-	(13,532)	-	-	-	-
Cumulative translation adjustment	-	-	-	-	-	(543,439)	-	(543,439)
Net loss for the period	-	-	-	-	-	-	(28,003)	(28,003)
Balance – July 31, 2012	**63,069,321**	**$ 15,977,713**	**$ -**	**$ 391,569**	**$ 255,342**	**$ (243,444)**	**$ (1,434,171)**	**$ 14,947,009**
Balance – January 31, 2013	**63,069,321**	**$ 15,977,713**	**$ -**	**$ 638,649**	**$ 255,342**	**$ 396,149**	**$ (1,527,890)**	**$ 15,739,963**
Convertible notes - equity components	-	-	2,912,745	-	-	-	-	2,912,745
Share-based payments	80,000	140,000	-	164,194	-	-	-	304,194
Cumulative translation adjustment	-	-	-	-	-	(593,694)	-	(593,694)
Net loss for the period	-	-	-	-	-	-	(1,036,396)	(1,036,396)
Balance – July 31, 2013	**63,149,321**	**$ 16,117,713**	**$ 2,912,745**	**$ 802,843**	**$ 255,342**	**$ (197,545)**	**$ (2,564,286)**	**$ 17,326,812**

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

TERRACE ENERGY CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS
UNAUDITED – PREPARED BY MANAGEMENT
(Expressed in United States Dollars)
For the six months ended July 31

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the period	$ (1,036,396)	$ (28,003)
Items not involving cash:		
Accretion of convertible notes	221,654	-
Depreciation, depletion and accretion	493,531	18,468
Equity income in partnership	(35,909)	-
Share-based payments	304,194	146,020
Unrealized loss (gain) on foreign exchange	(635,863)	24,482
Changes in non-cash working capital items:		
Accounts receivable	796,040	(70,831)
Prepaids	23,356	(130,579)
Accounts payable and accrued liabilities	575,308	108,562
Net cash provided by operating activities	705,915	68,119
CASH FLOWS FROM INVESTING ACTIVITIES		
Exploration and evaluation expenditures	(7,217,275)	(5,583,747)
Advances for future exploration	(1,431,811)	(981,350)
Acquisition of property and equipment	(192,074)	(59,437)
Acquisition costs	(794,415)	(815,412)
Investment in partnership	(12,864,525)	-
Net cash used in investing activities	(22,500,100)	(7,439,946)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from issuance of shares	-	9,975,232
Exercise of options	-	18,043
Net proceeds from issuance of convertible notes	37,236,344	-
Net cash provided by financing activities	37,236,344	9,993,275
Foreign exchange effect on cash	42,169	(7,077)
Change in cash for the period	15,484,328	2,614,371
Cash, beginning of the period	1,673,449	2,559,228
Cash, end of the period	$ 17,157,777	$ 5,173,599

Supplemental cash flow information (Note 16)

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

1. NATURE OF OPERATIONS

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

The Company's head office is located at 1012-1030 West Georgia St, Vancouver, British Columbia, Canada V6E 2Y3. It's registered and records office is located at 10th Floor, 595 Howe St, Vancouver, British Columbia, Canada V6C 2T5.

These condensed consolidated interim financial statements have been prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. The Company has a limited history of revenues and operating cash flows. The future development of the Company's oil and gas interests are therefore dependent upon its ability to raise additional capital as required and future profitable operations, neither of which is assured. These condensed consolidated interim financial statements do not include adjustments to amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue operations.

2. BASIS OF PRESENTATION

Statement of compliance

These unaudited condensed consolidated interim financial statements, including comparatives have been prepared using accounting policies consistent with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and in accordance with International Accounting Standards ("IAS") 34, Interim Financial Reporting. The policies applied in these condensed consolidated interim financial statements are based on IFRS issued and outstanding as of July 31, 2013. The Board of Directors approved the unaudited condensed consolidated interim financial statements on September 27, 2013.

Basis of measurement

These condensed consolidated interim financial statements have been prepared on a historical cost basis, except for certain financial instruments, which are measured at fair value. In addition, these condensed consolidated interim financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

Functional and presentation currency

The functional currency of the Company is the Canadian dollar ("CAD") because it is presently reliant upon the Canadian capital markets to fund its activities. However, these condensed consolidated interim financial statements are presented in United States dollars ("USD") because substantially all of the Company's assets and operations are situated in the USA. Assets and liabilities are translated into the presentation currency using the exchange rate in effect on the consolidated statement of financial position date, shareholders' equity accounts are translated into the presentation currency using the historical exchange rate, and revenues and expenses are translated at the average rate for the period, which approximates the exchange rate in effect on the transaction date. Exchange gains and losses on translation are included as a separate component in shareholders' equity as "translation reserve".

3. NEW ACCOUNTING POLICIES

Convertible notes

The liability component of convertible debentures is recognized initially at the fair value of a similar liability that does not have a conversion option. The equity component is recognized initially as the difference between the fair value of the convertible debenture as a whole and the fair value of the liability component. Transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts. Subsequent to initial recognition, the liability component of the convertible debenture is measured at amortized cost using the effective interest method. The equity component is not re-measured subsequent to initial recognition.

New accounting standards and interpretation

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2013, including IAS 19 *Employee Benefits,* IAS 27 *Separate Financial Statements,* IAS 28 *Investments in Associates and Joint Ventures,* IFRS 10 *Consolidated Financial Statements,* IFRS 11 *Joint Arrangements,* IFRS 12 *Disclosure of Interest of Other Entities,* and IFRS 13 *Fair Value Measurement.* The Company has adopted these policies and they do not have a significant effect on the condensed consolidated interim financial statements.

IFRS 9 *Financial Instruments* is effective for annual periods beginning after January 1, 2015. The extent of the effects of this new accounting standard on the condensed consolidated interim financial statements has not been determined.

4. INVESTMENT IN PARTNERSHIP

The Company and its partner, BlackBrush Oil & Gas, LP ("BlackBrush") organized a special purpose limited partnership, the BlackBrush Terrace LP (the "SPLP"), to acquire a 50% working interest in certain oil and gas leases in Maverick County Texas, USA (the "WI") from SWEPI LP ("Shell Oil").

The Company and BlackBrush have agreed that each party must fund its 50% share of the costs to drill and complete four horizontal wells in the Pearsall Shale and one horizontal well in the Eagle Ford Shale (the "Obligation Wells") or forfeit their respective interest in the SPLP and each party's interest in the SPLP may be adjusted, in defined circumstances, where one party finances a disproportionate share of costs to drill and complete additional wells.

The SPLP may secure the WI through a combination of cash payments, which have been made, and drilling obligations. The material terms of the agreement between the SPLP and Shell Oil are as follows:

1. the SPLP is obligated to commence drilling all of the remaining Obligation Wells on or before April 15, 2015;

2. the drilling of each Obligation Well must commence within 120 days of the completion of the previous well;

3. the SPLP is obligated to pay liquidated damages equal to $2 million ($1 million net to Terrace) for each Obligation Well that is not commenced on time;

4. upon completion of a well, the SPLP may request an assignment of 50% of Shell Oil's interest in such well;

5. the SPLP has the option, but not the obligation, to earn the assignment of the WI in all of the leases by spending an aggregate of $104 million ($52 million net to Terrace), including $52 million ($26 million net to Terrace) representing Shell Oil's share of costs, (the "Carry Payment") on certain qualified expenditures as development of the property progresses over time, including those incurred in connection with the drilling and completion of the Obligation Wells;

(Expressed in United States Dollars)

4. INVESTMENT IN PARTNERSHIP (continued)

6. upon making the Carry Payment in full, the SPLP will pay 50% of all development costs for the right to participate in a 50% working interest in each subsequent well unless Shell Oil elects to convert its working interest in a producing formation into a net profits interest; and

7. Shell Oil has the right, but not the obligation to assume operatorship of any formation in which production has been established at any time within two years after the later of (i) the Carry Payment is made in full or (ii) establishment of production from a given formation.

The Company accounts for its investment in the SPLP using the equity method. The carrying value of $12,900,434 at July 31, 2013, which includes $12,864,525 in advances, represents the Company's share of costs to organize, acquire and fund certain agreed upon exploration and evaluation activities to-date plus the Company's share of the changes in net assets of the partnership.

5. ADVANCES FOR FUTURE EXPLORATION

The Company owns varying interests in oil and gas properties subject to joint operating agreements, which provide, among other things, that the Company make advance payments from time to time to fund estimated exploration and evaluation costs. The amount of funds advanced, less the Company's share of actual costs incurred by the project operators, was $1,890,819 at July 31, 2013 (January 31, 2013 - $459,008), which consists of advances for future exploration on the Company's STS Olmos and Cutlass projects.

6. EXPLORATION AND EVALUATION ASSETS

	Los Patos	STS Olmos	Cutlass	Total
Balance - January 31, 2012	**$ 135,000**	**$ 1,058,108**	**$ 561,713**	**$ 1,754,821**
Acquisition costs	-	1,269	1,362,343	1,363,612
Exploration and evaluation	-	6,732,483	3,842,044	10,574,527
Transfer to property and equipment	-	(6,820,921)	-	(6,820,921)
Impairment charge	(135,000)	-	-	(135,000)
Expenditures during the year	(135,000)	(87,169)	5,204,387	4,982,218
Balance - January 31, 2013	**-**	**970,939**	**5,766,100**	**6,737,039**
Acquisition costs	-	-	794,415	794,415
Exploration and evaluation	-	4,133,799	3,083,476	7,217,275
Transfer to property and equipment	-	-	(3,869,748)	(3,869,748)
Expenditures during the period	-	4,133,799	8,143	4,141,942
Balance - July 31, 2013	**$ -**	**$ 5,104,738**	**$ 5,774,243**	**$ 10,878,981**

STS Olmos

The Company acquired, through a wholly-owned subsidiary, varying working and net revenue interests in leases covering approximately 14,400 gross mineral acres in LaSalle and McMullen Counties, Texas which average 26.88% and 20.16% respectively. The acquisition price included one minimally producing well and one additional wellbore which had been suspended pending further evaluation. The aggregate purchase price was $1,001,269.

The Company's share of the aggregate costs, to drill, complete and place into production three wells was $6,760,921. These costs and $60,000 of the acreage lease acquisition costs were transferred from "Exploration and Evaluation assets" to "Property and Equipment" during the last fiscal year.

6. EXPLORATION AND EVALUATION ASSETS (continued)

The Company also participated in drilling of four additional development wells, bringing the total number of wells drilled on the Company's leasehold interests to seven. Two of these wells were placed into production subsequent to July 31, 2013. The two remaining wells are currently undergoing completion operations and are expected to be placed into production in the next quarter.

The Company has secured its working and net revenue interests in all of the project acreage subject to participation in the development of additional wells proposed from time to time by the project's operator.

Cutlass

In November 2011 and February 2012, the Company entered into agreements, through a wholly-owned subsidiary, to earn a 30% working interest and a 22.5% net revenue interest in certain leases covering 3,395 net acres in Dimmit and LaSalle counties. The purchase consideration consisted of aggregate payments of $1,172,225 and a commitment to participate in the development of an evaluation well and three operating wells.

In order to earn the 30% working interest (22.5% net revenue interest) in the first 1,342 net acres (the "Dimmit County Acreage"), the Company agreed to pay 33.33% of all costs, including acreage leases, prospect fees, site preparation, infrastructure, drilling, and completion costs for two development wells through initial production. The added 3.33% carry represents additional lease purchase consideration. The Company will be responsible for 30% of all approved capital expenditures for additional development wells beyond the initial two wells.

Drilling of the first obligation well on the Dimmit County Acreage was substantially completed in June 2012. The results were subsequently analyzed and the well was fracture stimulated on March 28, 2013 and placed in limited production in June, 2013. The Company's share of the aggregate costs to drill, complete and place the well into production to July 31, 2013 was $3,795,500. This cost and $74,248 of the acreage lease acquisition costs were transferred from "Exploration and Evaluation assets" to "Property and Equipment" during the period.

The Company also participated in drilling the second obligation well on the Dimmit County acreage. The Company's share of well and infrastructure costs to July 31, 2013 was $915,264. This well is currently in the completion stage of development. Upon completion and production initiation of this second development well, the Company will have completed its contractual obligations required to earn its working and net revenue interest in the Dimmit County Acreage.

In order to earn the 30% working interest (22.5% net revenue interest) in the remaining 2,053 net acres (the "LaSalle County Acreage"), the Company agreed to fund 30.00% of the cost of a vertical evaluation well, and 33.33% of all costs, including acreage leases, prospect fees, site preparation, infrastructure, drilling and completion costs for the initial development well through initial production. The added 3.33% carry represents additional lease purchase consideration. The Company will be responsible for and 30% of the cost of a second well on the La Salle County Acreage.

Drilling of the evaluation well on the La Salle County Acreage commenced in late June 2012. A vertical hole was drilled through several objective formations and is currently suspended for service as a microseismic monitor well. The Company's share of the evaluation well and infrastructure costs to July 31, 2013 was $1,492,758.

The initial development well on the La Salle County Acreage was spudded on April 26, 2013. The costs of this well were $916,045 as at July 31, 2013. Upon completion and production initiation of this second development well, the Company will have completed its contractual obligations required to earn its working and net revenue interests in the LaSalle County Acreage.

At July 31, 2013 the Company advanced the total sum of $322,453 to cover planned exploration on the Cutlass project in 2013 (Note 5).

(Expressed in United States Dollars)

7. PROPERTY AND EQUIPMENT

Cost	Other Equipment	Leaseholds	Oil and Gas	Total
Balance – January 31, 2012	$ -	$ -	$ -	$ -
Additions	63,597	-	-	63,597
Transfer from exploration and evaluation	-	-	6,820,921	6,820,921
Change in value of decommissioning obligations	-	-	7,294	7,294
Balance – January 31, 2013	**63,597**	**-**	**6,828,215**	**6,891,812**
Additions	42,656	149,418	-	192,074
Transfer from exploration and evaluation	-	-	3,869,748	3,869,748
Balance – July 31, 2013	**$ 106,253**	**$ 149,418**	**$ 10,697,963**	**$ 10,953,634**

Accumulated depreciation and depletion	Other Equipment	Leaseholds	Oil and Gas	Total
Balance – January 31, 2012	$ -	$ -	$ -	$ -
Charge for year	11,274	-	833,010	844,284
Balance – January 31, 2013	**11,274**	**-**	**833,010**	**844,284**
Charge for period	1,602	5,612	486,317	493,531
Balance – July 31, 2013	**$ 12,876**	**$ 5,612**	**$ 1,319,327**	**$ 1,337,815**

Net book value	Other Equipment	Leaseholds	Oil and Gas	Total
Balance – January 31, 2013	**$ 52,323**	**$ -**	**$ 5,995,205**	**$ 6,047,528**
Balance – July 31, 2013	**$ 93,377**	**$ 143,806**	**$ 9,378,636**	**$ 9,615,819**

8. CONVERTIBLE NOTES

During the current period, the Company completed two non-brokered private placements of convertible, unsecured promissory notes in the aggregate principal amount of CAD $40,000,000. The convertible notes are due on April 2, 2018, pay interest of 8% per annum and are convertible into 20,000,000 common shares of the Company at CAD $2.00 per share.

The Company has the right to convert of all or part of the convertible notes into common shares at any time after April 2, 2014 if the market price of the common shares on the TSX Venture Exchange (the "Exchange") trades at CAD $2.80 or higher for a period of 30 consecutive trading days. In addition, the Company has a limited right to redeem all or part of the convertible notes at any time after April 2, 2014 by offering cash equal to 1.08 multiplied by the principal amount that is called for redemption.

Holders of the convertible notes may convert all or part of the outstanding principal amount of their convertible notes at the conversion price at any time during the term of the convertible notes. In the event of a change of control of the Company, where a person acquires more than 50% of the outstanding common shares of the Company, holders of convertible notes will be entitled to require the Company to redeem the convertible notes in certain circumstances.

(Expressed in United States Dollars)

8. CONVERTIBLE NOTES (continued)

The liability component of the convertible debentures was recognized initially at the fair value of a similar liability that does not have an equity conversion option, which was calculated based on the application of a market interest rate of 10%. The difference between the CAD $40 million face value of the debentures and the fair value of the liability component was recognized in equity. Transaction costs directly attributable to the offering of $1,647,656 were allocated to the liability and equity components of the debentures proportionately at $1,518,741 and $128,915, respectively. The discount on the debentures is being accreted such that the liability component will equal the face value of the debentures at maturity.

The following table reconciles the fair value of the convertible debentures on initial recognition to the carrying amount at July 31, 2013:

	Liability	Equity	Total
Subscription proceeds	$ 35,842,340	$ 3,041,660	$ 38,884,000
Transaction costs	(1,518,741)	(128,915)	(1,647,656)
Accretion of discount	221,654	-	221,654
Balance, July 31, 2013	$ 34,545,253	$ 2,912,745	$ 37,457,998

9. DECOMMISIONING OBLIGATIONS

The Company's decommissioning obligations result from its ownership interest in oil and 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.

Balance - January 31, 2012	$ -
Increase in estimated future obligations	7,294
Accretion expense	722
Balance - January 31, 2013 and July 31, 2013	$ 8,016

10. CAPITAL STOCK

On July 31, 2013 and January 31, 2013, the Company had unlimited authorized common shares, without par value and 63,149,321 shares outstanding.

Share issues

During the six month period ended July 31, 2013, the Company issued 80,000 common shares having a value of $140,000 as partial compensation to the president of the Company.

During the year ended January 31, 2013, the Company issued common shares as follows:

a) In May 2012, the Company completed a private placement of 10,000,000 common shares at a purchase price of CAD $1.00 per share for gross proceeds of CAD $10,000,000. Share issue costs of CAD $48,670 were paid in connection with the private placement.

b) In July 2012, the Company issued 150,000 common shares on the exercise of stock options at an exercise price of CAD $0.12 per share for gross proceeds of CAD $18,000.

Restricted shares and warrants

Of the common shares issued, 7,456,230 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 a total of 3,728,115 common shares will be released from escrow on December 23, 2013 and the balance on June 23, 2014.

Of the common shares underlying the outstanding warrants, 1,725,000 are subject to an escrow agreement and cannot be transferred without the consent of the Exchange. The escrow agreement provides that a total of 862,500 warrants will be released from escrow on December 23, 2013 and the balance on June 23, 2014.

Included in the issued common shares and warrants are 1,500,000 common shares and warrants to purchase 900,000 common shares that are subject to a voluntary pooling agreement. The agreement provides that 750,000 common shares and 450,000 warrants will be released from trading restrictions on December 23, 2013 and the balance on June 23, 2014.

Convertible Notes

As at July 31, 2013, the Company had issued and outstanding notes in the aggregate principal amount of CAD $40,000,000 convertible into 20,000,000 common shares of the Company (see Note 8).

Stock options

The Company has an incentive stock option plan, which provides that the Board of Directors of the Company may from time to time, in its discretion, and in accordance with Exchange requirements, grant to directors, officers, employees and technical consultants to the Company, non-transferable options to purchase common shares, provided that the number of common shares reserved for issuance will not exceed 10% of the issued and outstanding common shares. The number of common share reserves for issuance pursuant to options granted to all technical consultants will not exceed 2% of the issued and outstanding common shares. The number of options granted to any one person cannot exceed 5% of the issued and outstanding common shares. Such options may be exercisable for a period of up to 10 years from the date of grant. Vesting terms will be determined at the time of grant by the Board of Directors.

(Expressed in United States Dollars)

10. CAPITAL STOCK (continued)

Share-based payments

The Company uses a fair value method of accounting for all share-based payments arising from the grant of stock options. Under this method, the Company recorded share-based payments expense of $164,194 for the period ended July 31, 2013 (2012 - $146,020), with a corresponding credit to reserves. The fair value of the stock options granted during the period ended July 31, 2013 is estimated as at the date of grant using the Black-Scholes pricing model assuming the following weighted average assumptions:

	2013	2012
Risk-free interest rate	-	1.16%
Expected life	-	5 years
Annualized volatility	-	107.49%
Pre-vest forfeiture rate	-	0%
Dividend rate	-	0%

During the period ended July 31, 2013, the Company granted Nil (2012 – 150,000) options with a fair value of $Nil (2012 - $150,185), which is being expensed over the vesting periods of the options. The Company also issued 80,000 common shares valued at $140,000 based upon the Company's share price at the approximate date of issue (included in share-based payments) as partial compensation to the president of the Company.

Outstanding stock options and warrants

Stock option transactions and the number of stock options outstanding are summarized as follows:

	Number of Stock Options	Weighted Average Exercise Price (CAD)
Balance - January 31, 2012	2,900,000	$ 0.20
Granted	150,000	$ 1.35
Exercised	(150,000)	$ 0.12
Balance - January 31, 2013 and July 31, 2013	2,900,000	$ 0.27

The following stock options were outstanding as at July 31, 2013:

Number of Options	Number of Options Exercisable	Exercise Price (CAD)	Expiry Date	Weighted Average Remaining Contractual Life (Years)
1,650,000	1,650,000	$ 0.12	June 22, 2016	2.89
250,000	175,000	$ 0.19	July 15, 2016	2.96
250,000	137,500	$ 0.21	September 16, 2016	3.10
250,000	137,500	$ 0.19	October 18, 2016	3.22
100,000	80,000	$ 0.53	November 25, 2016	3.32
250,000	137,500	$ 0.67	December 16, 2016	3.46
150,000	60,000	$ 1.35	July 8, 2017	3.94
2,900,000	2,377,500			3.06

(Expressed in United States Dollars)

10. CAPITAL STOCK (continued)

Outstanding stock options and warrants (continued)

Warrant transactions and the number of warrants outstanding are summarized as follows:

	Number of Warrants	Weighted Average Exercise Price (CAD)	Expiry Date
Balance - January 31, 2012, 2013 and July 31, 2013	7,112,500	$ 0.18	June 21, 2016

11. FINANCIAL INSTRUMENTS

The Company has classified its financial instruments as follows:

- Cash – as FVTPL;
- Accounts receivable and operators bond – as loans and receivables; 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, accounts receivable, and accounts payable and accrued liabilities approximate their fair values due to the short-term maturity of these financial instruments. The fair value of the operators bond also approximates its carrying value.

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 accounts receivable. The credit risk associated with cash is mitigated since the cash is held at major financial institutions with high credit ratings. Accounts receivable consists primarily of trade receivables outstanding from operators of its oil and gas interests. To mitigate this risk, the Company regularly reviews the collectability of accounts receivable to ensure there is no indication that these amounts will not be fully recoverable.

(Expressed in United States Dollars)

11. FINANCIAL INSTRUMENTS (continued)

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

Foreign currency risk is the risk that the future cash flow of financial instruments will fluctuate as a result of changes in foreign exchange rates. The Company's financing is raised in CAD, but substantially all of the Company's operations are conducted in USD. Therefore, the Company is impacted by changes in the exchange rate between the Canadian and US dollars.

The following assets and liabilities represent the Company's exposure to foreign currency risk:

	July 31, 2013 (USD)	January 31, 2013 (USD)
Cash	$ 10,802,593	$ 1,502,509
Accounts receivable	500,588	1,302,356
Operators bond	25,000	25,000
Accounts payable and accrued liabilities	(520,407)	(483,690)
Net	$ 10,807,774	$ 2,346,175
Canadian dollar equivalent	CAD$ 11,116,876	CAD$ 2,344,399

Based on the above net exposures as at July 31, 2013, a 5% change in the Canadian/US exchange rate would impact the Company's net loss and comprehensive loss by approximately $540,400.

(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.

11. FINANCIAL INSTRUMENTS (continued)

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 July 31, 2013, the Company had cash of $17,157,777, accounts receivable of $531,470, prepaid expenses of $26,673 and accounts payable and accrued liabilities of $1,146,892 due within three months of period-end.

The Company has long term convertible notes in the aggregate principal amount of CAD $40,000,000, which are due on April 2, 2018. These notes bear interest calculated at 8% per annum, which is payable quarterly, and may become immediately due in the event of default (see Note 8).

The Company owns varying interests in oil and gas properties subject to joint operating agreements, which provide, among other things, that the Company make advance payments from time to time to fund its share of estimated exploration and evaluation costs. The Company may not have sufficient working capital and future cash flow from operations to fund its share of the agreed-upon estimated costs of proposed development activities. As a consequence, the Company may have to secure new sources of capital, which is not assured, to maintain its interests in such proposed development.

12. CAPITAL DISCLOSURES

The Company considers its capital under management to be shareholders' equity and convertible notes. The Company's capital management objectives are to ensure the Company continues as a going concern, as well as to maintain optimal returns to shareholders and benefits for other stakeholders. The Board of Directors does not establish quantitative criteria for management, but rather relies on management expertise to sustain future development. Management will adjust the capital structure as necessary to achieve the objectives.

The Company's capital management strategy has not changed from January 31, 2013. As at July 31, 2013, the Company is not subject to any externally imposed capital requirements.

13. COMMITMENTS

The Company has a commitment to make monthly rental payments pursuant to an office rental agreement in Houston, Texas. The agreement expires June 30, 2014 and will require total payments of $72,183 for January 31, 2014 and $30,076 for January 31, 2015.

The Company entered into a new office lease in Vancouver, British Columbia, which commenced on July 1, 2013 for a term of seven years. The lease requires total annual payments of CAD $68,824 in years one and two; CAD $72,511 in years three, four and five; and CAD $76,198 in years six and seven.

The Company is required to pay interest, calculated at 8% per annum, on outstanding convertible notes at the end of each fiscal quarter. The Company has estimated that it must pay approximately CAD $800,000 each quarter subsequent to July 31, 2013 until the notes are converted or repaid.

The Company has interests in certain exploration and evaluation assets which are subject to certain expenditure commitments (Note 4 and Note 6).

(Expressed in United States Dollars)

14. RELATED PARTY TRANSACTIONS

Key management personnel include executive officers and directors of the Company. Compensation of the Company's key management personnel is comprised of the following:

	2013	2012
Short-term compensation	$ 364,831	$ 54,531
Share-based payments	150,468	10,939
	$ 515,299	$ 65,470

During the period ended July 31, 2013, the Company issued 80,000 common shares, having a value of $140,000, as partial compensation to the Company's president, included in share-based payments.

Included in accounts payable and accrued liabilities as at July 31, 2013 are amounts payable to key management personnel totalling $46,374 (January 31, 2013 - $42,368).

15. SEGMENTED INFORMATION

The Company has one operating segment, which is the acquisition and exploration of oil and gas properties. Geographic segmentation of the Company's non-current assets is as follows:

	July 31, 2013		
	USA	Canada	Total
Advances for future exploration	$ 1,890,819	$ -	$ 1,890,819
Exploration and evaluation assets	10,878,981	-	10,878,981
Property and equipment	9,423,745	192,074	9,615,819
Investment in partnership	12,900,434	-	12,900,434
	$ 35,093,979	$ 192,074	$ 35,286,053

	January 31, 2013		
	USA	Canada	Total
Advances for future exploration	$ 459,008	$ -	$ 459,008
Exploration and evaluation assets	6,737,039	-	6,737,039
Property and equipment	6,047,528	-	6,047,528
	$ 13,243,575	$ -	$ 13,243,575

Exploration and development activities are located in the US and oil and gas revenues are derived from US operations.

16. SUPPLEMENTAL CASH FLOW INFORMATION

During the six months ended July 31 2013, the Company transferred $3,869,748 from exploration and evaluation assets to property and equipment.

During the six months ended July 31 2012, the Company:

(a) transferred $1,425,041 from exploration and evaluation assets to property and equipment.
(b) transferred $13,532 from equity reserves to share capital on the exercise of stock options.