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

FOR THE SIX AND THREE MONTHS ENDED JULY 31, 2015 AND 2014

TERRACE ENERGY CORP.

NOTICE OF NO AUDITOR REVIEW OF CONDENSED CONSOLIDATED 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 condensed consolidated 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 condensed consolidated 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 29, 2015

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

	July 31, 2015	January 31, 2015
ASSETS		
Current assets		
Cash	$ 10,434,804	$ 26,494,024
Accounts receivable (Notes 9 and 17)	1,492,011	1,482,629
Prepaids	200,425	268,875
Assets held for sale (Note 4)	1,762,845	1,762,845
Total current assets	13,890,085	30,008,373
Non-current assets		
Operators bond	25,000	25,000
Investment in partnership (Note 5)	18,016,870	16,622,882
Advances for future exploration (Notes 6 and 9)	848,130	475,797
Exploration and evaluation assets (Notes 7 and 9)	4,500,103	4,235,900
Property and equipment (Notes 8 and 9)	24,742,751	22,268,239
Total assets	$ 62,022,939	$ 73,636,191
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (Note 17)	$ 1,308,026	$ 4,566,006
Total current liabilities	1,308,026	4,566,006
Non-current liabilities		
Credit facility (Note 9)	23,864,530	23,451,243
Convertible notes (Notes 10 and 17)	27,374,750	27,844,656
Decommissioning obligations (Note 11)	534,298	474,257
Total liabilities	53,081,604	56,336,162
Shareholders' equity		
Capital stock (Note 12)	47,416,203	47,416,203
Convertible notes – equity component (Note 10)	2,814,173	2,814,173
Stock options reserve (Note 12)	1,064,741	1,061,669
Warrants reserve (Note 12)	6,099	6,099
Translation reserve (Notes 2 and 5)	(1,055,281)	(1,380,307)
Deficit	(41,304,600)	(32,617,808)
Total shareholders’ equity	8,941,335	17,300,029
Total liabilities and shareholders’ equity	$ 62,022,939	$ 73,636,191

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, 2015	For the six months ended July 31, 2014	For the three months ended July 31, 2015	For the three months ended July 31, 2014
REVENUE				
Oil and gas sales (net of royalties)	$ 3,847,845	$ 4,045,870	$ 1,911,533	$ 1,503,040
DIRECT OPERATING EXPENSES				
Production and operating	1,003,330	959,406	552,872	495,857
Depreciation and depletion (Note 8)	3,672,721	1,411,970	1,924,390	606,883
Operating income	(828,206)	1,674,494	(565,729)	400,300
Equity loss in partnership (Note 5)	(106,013)	(85,903)	(39,998)	(29,065)
	(934,219)	1,588,591	(605,727)	371,235
GENERAL AND ADMINSTRATIVE EXPENSES				
Administrative	446,028	430,583	221,089	274,818
Foreign exchange (gain) loss	740,697	(380,799)	(719,962)	(193,273)
Impairment (Notes 4 and 7)	3,031,109	(18,465)	2,655,593	(49,471)
Financing (Note 13)	3,198,497	1,767,642	1,454,528	917,097
Investor relations	256,628	143,197	78,449	84,320
Professional	307,622	345,579	194,305	251,556
Salaries and benefits (Note 17)	993,077	752,069	492,914	406,317
Share-based payments (Notes 12 and 17)	3,072	99,951	-	41,219
Transfer agent and filing fees	42,520	44,105	16,521	18,237
Travel	13,884	56,096	7,700	42,998
	9,033,134	3,239,958	4,401,137	1,793,818
Net loss for the period	(9,967,353)	(1,651,367)	(5,006,864)	(1,422,583)
Other comprehensive loss				
Items that may be reclassified subsequently to profit or loss:				
Cumulative translation adjustment	325,026	(88,965)	586,053	(7,356)
Comprehensive loss for the period	$ (9,642,327)	$ (1,740,332)	$ (4,420,811)	$ (1,429,939)
Basic and diluted income (loss) per share	$ (0.11)	$ (0.02)	$ (0.06)	$ (0.02)
Weighted average number of common shares outstanding	87,844,321	75,652,627	87,844,321	76,309,821

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		Convertible Notes – Equity	Stock Options	Warrants	Translation		Total Shareholders'
	Shares	Amount	Component	Reserve	Reserve	Reserve	Deficit	Equity
Balance – January 31, 2014	**74,434,321**	**$ 27,421,256**	**$ 2,829,976**	**$ 924,942**	**$ 17,239**	**$(1,732,922)**	**$ (8,103,382)**	**$ 21,357,109**
Short form prospectus	12,443,000	21,279,272						21,279,272
Share issue costs	-	(1,654,536)	-	-	-	-	-	(1,654,536)
Exercise of convertible notes	92,500	153,729	(12,681)	-	-	-	-	141,048
Exercise of warrants	850,000	138,429	-	-	-	-	-	138,429
Fair value of warrant exercises	-	11,140	-	-	(11,140)	-	-	-
Share-based payments	-	-	-	99,951	-	-	-	99,951
Cumulative translation adjustment	-	-	-	-	-	(88,965)	-	(88,965)
Net loss for the period	-	-	-	-	-	-	(1,651,367)	(1,651,367)
Balance – April 30, 2014	**87,819,821**	**$ 47,349,290**	**$ 2,817,295**	**$ 1,024,893**	**$ 6,099**	**$(1,821,887)**	**$ (9,754,749)**	**$ 39,620,941**
Balance – January 31, 2015	**87,844,821**	**$ 47,416,203**	**$ 2,814,173**	**$ 1,061,669**	**$ 6,099**	**$(1,380,307)**	**$(32,617,808)**	**$ 17,300,029**
Effect of change in functional currency (Note 2)	-	-	-	-	-	(1,992,239)	1,280,561	(711,678)
Share-based payments	-	-	-	3,072	-	-	-	3,072
Cumulative translation adjustment	-	-	-	-	-	2,317,265	-	2,317,265
Net loss for the period	-	-	-	-	-	-	(9,967,353)	(9,967,353)
Balance – July 31, 2015	**87,844,821**	**$ 47,416,203**	**$ 2,814,173**	**$ 1,064,741**	**$ 6,099**	**$(1,055,281)**	**$(41,304,600)**	**$ 8,941,335**

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

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the period	$ (9,967,353)	$ (1,651,367)
Items not involving cash:		
Accretion of convertible notes	314,927	340,618
Accretion of decommissioning obligations	5,378	-
Depreciation and depletion	3,672,721	1,411,970
Equity loss in partnership	106,013	85,903
Share-based payments	3,072	101,222
Non-cash interest expense	483,589	-
Impairment of assets held for sale	-	-
Impairment of exploration and evaluation assets	3,031,109	-
Unrealized (gain) loss on foreign exchange	(110,110)	98,378
Changes in non-cash working capital items:		
Accounts receivable	(56,941)	934,717
Prepaids	116,009	(31,635)
Accounts payable and accrued liabilities	(2,007,193)	1,588,333
Net cash provided by (used in) operating activities	(4,408,779)	2,878,139
CASH FLOWS FROM INVESTING ACTIVITIES		
Exploration and evaluation expenditures	(9,745,464)	(2,804,163)
Advances for future exploration	(372,334)	(1,748,042)
Acquisition of property and equipment	-	(41,780)
ARO assets	37,659	-
Investment in partnership	(1,500,000)	(725,000)
Net cash used in investing activities	(11,580,139)	(5,318,985)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from issuance of shares	-	19,624,736
Exercise of warrants	-	138,429
Financing costs	(70,302)	(171,331)
Net cash provided by financing activities	(70,302)	19,591,834
Foreign exchange effect on cash	-	(86,870)
Change in cash for the period	(16,059,220)	17,064,118
Cash, beginning of the period	26,494,024	11,097,174
Cash, end of the period	$ 10,434,804	$ 28,161,292

Supplemental cash flow information (Note 18)

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

1. NATURE OF OPERATIONS

Terrace Energy Corp. (the "Company" or "Terrace") was incorporated on July 6, 2006 under the *Business Corporations Act* (British Columbia) and previously named Terrace Resources Inc. The Company is in the business of acquiring, exploring for and developing conventional onshore oil and gas properties in the United States.

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

The Company is classified as a "Tier 2 Oil and Gas Issuer", as those terms are defined in TSX Venture Exchange (the "Exchange") policies. Its common shares trade on the Exchange under the symbol "TZR".

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 in accordance with International Accounting Standards ("IAS") 34, Interim Financial Reporting. The accounting policies used in the preparation of these condensed consolidated interim financial statements are the same as those applied in the Company's most recent consolidated annual financial statements for the year ended January 31, 2015. These condensed consolidated interim financial statements should be read in conjunction with the Company's consolidated annual financial statements for the year ended January 31, 2015. The policies applied in these condensed consolidated interim financial statements are based on IFRS issued and outstanding as of July 31, 2015.

The Board of Directors approved the unaudited condensed consolidated interim financial statements on September 28, 2015.

Basis of measurement

These condensed consolidated 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 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"), as it is presently reliant upon the Canadian capital markets to fund its activities. The functional currencies of the Company's foreign subsidiaries are the CAD and the United States dollar ("USD"). The Company changed the functional currency of certain subsidiaries from CAD to USD with effect from February 1, 2015. The change in functional currency arose due to changing sources of recent and expected futures sources of financing. The change in functional currency was applied prospectively. The assets, liabilities and equity of the subsidiaries were translated from CAD to USD at the exchange rate on the date of change in functional currency. The resulting exchange differences were recognized in other comprehensive loss. These condensed consolidated interim financial statements are presented in USD, as substantially all of the

2. BASIS OF PRESENTATION (Continued)

Functional and presentation currency (Continued)

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 condensed 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. SIGNIFICANT ACCOUNTING POLICIES

Use of judgments and estimates

The preparation of condensed consolidated interim financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, revenues and expenses. Actual results may differ from these estimates.

Following are the accounting policies subject to such judgments and the key sources of estimation uncertainty that the Company believes could have the most significant impact on the reported results and financial position.

Reserves

The estimate of oil and natural gas reserves is integral to the calculation of the amount of depletion charged to the condensed consolidated statements of operations and comprehensive loss and is also a key determinant in assessing whether the carrying value of any of the Company's development and production assets have been impaired. Changes in reported reserves can impact asset carrying values and the decommissioning provision due to changes in expected future cash flows. The Company's reserves are evaluated and reported on by independent reserve engineers at least annually in accordance with Canadian Securities Administrators' National Instrument 51-101 *Standards of Disclosure of Oil and Gas Activities* ("NI 51-101"). Reserve estimation is based on a variety of factors including engineering data, geological and geophysical data, projected future rates of production, commodity pricing and timing of future expenditures, all of which are subject to significant judgment and interpretation.

Identification of cash-generating units ("CGUs")

The Company's assets are aggregated into CGUs for the purpose of calculating impairment. A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of cash inflows of other assets or groups of assets. The allocation of assets into CGUs requires significant judgment and interpretation with respect to the way in which management monitors operations.

Recoverability of asset carrying values

At each reporting date, the Company assesses its petroleum and natural gas properties and exploration and evaluation assets for possible impairment, to determining if there is any indication that the carrying amounts of the assets may not be recoverable. An assessment is also made at each reporting date to determine whether there is an indication that previously recognized impairment losses no longer exist or have decreased. Determination as to whether and how much an asset is impaired, or no longer impaired, involves management estimates on highly uncertain matters, such as future commodity prices, discount rates, production profiles, operating costs, future capital costs and reserves.

A material adjustment to the carrying value of the Company's property and equipment and exploration and evaluation assets could arise as a result of changes to these estimates and assumptions.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of judgments and estimates (Continued)

Classification of exploration and evaluation assets

The application of the Company's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances and as to whether economic quantities of reserves will be found so as to assess if technical feasibility and commercial viability have been achieved.

Assets held for sale

Judgment is required in determining whether an asset meets the criteria for classification as "assets held for sale" in the condensed consolidated statements of financial position. Criteria considered by management include the existence of and commitment to a plan to dispose of the assets, the expected selling price of the assets, the expected timeframe of the completion of the anticipated sale and the period of time any amounts have been classified within assets held for sale. The Company reviews the criteria for assets held for sale each quarter and reclassifies such assets to or from this financial position category as appropriate. In addition, there is a requirement to periodically evaluate and record assets held for sale at the lower of their carrying value and fair value less costs to sell.

Joint arrangements

Judgment is required to determine when the Company has joint control over an arrangement, which requires an assessment of the relevant activities and when the decisions in relation to those activities require unanimous consent. Judgment is also required to classify a joint arrangement. Classifying the arrangement requires the Company to assess their rights and obligations arising from the arrangement including whether the arrangement is structured through a separate vehicle, in which case, judgment is also required to assess the rights and obligations arising from the legal form of the separate vehicle, terms of the contractual arrangement and other relevant facts and circumstances. This assessment often requires significant judgment, and a different conclusion on joint control and whether the arrangement is a joint operation or a joint venture, may materially impact the accounting. Management has assessed the investment in partnership as a joint venture.

Functional currency

The determination of the functional currency for the Company and each of its subsidiaries was based on management's judgment of the underlying transactions, events and conditions relevant to each entity.

Principles of consolidation

The condensed consolidated financial statements include the financial statements of the Company and its controlled subsidiaries. All intercompany transactions, balances, revenues and expenses are eliminated in full on consolidation.

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%
TEC Operating, LLC	USA	100%
Terrace BWP, LLC	USA	100%
Terrace Investment Holdings, Inc.	USA	100%
TEC Olmos, LLC	USA	100%

(Expressed in United States Dollars)

4. ASSETS HELD FOR SALE

During the year ended January 31, 2014, the Company funded all of the costs necessary and was assigned its working interests in the properties that comprise the Cutlass Eagle Ford Development Project. Upon completing a project review, management determined that the project was no longer a core asset and decided to solicit bids from prospective purchasers.

As the proposed sale met the definition of "assets held for sale" under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, as of January 31, 2014 the assets and liabilities associated with the Company's interests in the project were reclassified from their respective financial position classifications to "assets held for sale" and "liabilities associated with assets held for sale".

In August, 2014, the project operator made a claim that the Company did not meet its obligations and demanded it reassign its interests in the leases. The Company denied the claim as unfounded and without merit. This matter was not resolved and the property had not been sold as of the quarter ended October 31, 2014 and, accordingly the Company reclassified the assets back to the appropriate financial position classifications due to the difficulty the Company experienced in marketing the sale of its interest in the project.

In April 2015, the litigation was settled and the Company's interest in the acreage was affirmed. As a condition of settlement, the Company agreed to use its best efforts to sell the project. Accordingly, the Company has reclassified the assets and liabilities associated with the Company's interests in the project from their respective financial position classifications to "assets held for sale". Management has evaluated the expected fair value less costs to sell and determined that it is lower than the carrying value and therefore recognized a further impairment charge of $7,710,967 during the year ended January 31, 2015. The fair value less costs to sell was based on an offer to purchase the asset and categorized in Level 3 of the fair value hierarchy. Based on these factors, assets held for sale were remeasured at $1,762,845 as of January 31, 2015, being the lower of carrying value and fair value less costs to sell.

In accordance with IFRS 5, as of January 31, 2015 the assets and liabilities associated with the Company's interests in Cutlass were reclassified from their respective financial position classifications to "assets held for sale" as follows:

Assets reclassified from		
Exploration and evaluation assets (Note 7)	$	3,094,834
Property and equipment (Note 8)		6,154,229
Accumulated depreciation and depletion		(1,542,534)
ARO liability, net		(6,969)
Impairment		(6,151,913)
Effect of foreign exchange		215,198
Balance as of January 31, 2015 and July 31, 2015	$	1,762,845

During the period ended July 31, 2015, the project generated operating loss of $16,349 (2014 income - $468,766), comprising revenues and expenses of $191,230 and $207,579 (2014 - $894,589 and $425,823), respectively.

5. INVESTMENT IN PARTNERSHIP

The Company and its partner, BlackBrush Oil & Gas, LP ("BlackBrush") organized a special purpose limited partnership, the BlackBrush Terrace LP (the "BTLP"), to acquire a 50% working interest (the "WI") in certain oil and gas leases in Maverick County Texas, USA (the "Maverick County Project") from SWEPI LP ("Shell Oil"). The acreage to be acquired includes potential reserves in the newly emerging Pearsall Shale Trend, as well as the Eagle Ford Shale, Buda Limestone and several other intervals of Cretaceous age formations, which have been proven productive on a regional basis. The BTLP may secure the WI through a combination of cash payments, which have been made, and drilling obligations. The material terms of the farm-out agreement between the BTLP and Shell Oil are as follows:

1) the BTLP has the option, but not the obligation, to earn the assignment of the WI in all of the leases by spending an aggregate $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;

2) upon completion of a well drilled under this agreement, the BTLP may request an assignment of 50% of Shell Oil's interest in such well;

3) upon making the Carry Payment in full, the BTLP shall have the option, but not the obligation, to pay 50% of all development costs for the right to participate in a 50% working interest in each subsequent well by paying its proportionate share of all development costs for such well unless Shell Oil elects to convert its working interest in a producing formation into a net profits interest; and

4) 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 being made in full and subsequent assignment of 50% of Shell Oil's interest in the subject leases or (ii) establishment of commercial production from a given formation.

During the year ended January 31, 2015, the BTLP successfully renegotiated the drilling obligations under the farm-out agreement predominantly to amend the required targets and timing of future wells necessary to fulfill the remaining earning requirements. Under the revised agreement, the BTLP has the flexibility to choose locations, set objectives and govern timing of operations under a blanket requirement to spend $25 million per year ($12.5 million net to Terrace) commencing January 1, 2015 until the total required drilling carry of $104 million has been spent. The BTLP is obligated to pay liquidated damages equal to $2 million ($1 million net to Terrace) in the event that the minimum expenditure is not met in any given year. The BTLP is currently in discussions with Shell Oil to reduce the amount required to be funded during 2015 and 2016. There can be no assurances that the BTLP will be successful in negotiating the reduction of such expenditure requirements.

By design, the BTLP partnership agreement allows for adjusting the ownership interests of the limited partnership by introducing third party investors into the partnership and/or allowing either partner to disproportionately fund future capital requirements. In light of the current economic environment, the Company has obtained a commitment from its partner, BlackBrush, to fund Terrace's share of capital obligations for fiscal 2016. As a result, the Company’s partnership interest in the BTLP is expected to be reduced from 50% to approximately 45% and its current obligations carried.

The carrying value of $18,016,870 at July 31, 2015 (January 31, 2015 - $16,622,882), which includes $23,679,357 (January 31, 2015 - $22,179,357) 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 cumulative net loss of the partnership of $5,662,487 (January 31, 2015 - $5,556,474).

(Expressed in United States Dollars)

5. INVESTMENT IN PARTNERSHIP (Continued)

Summary of financial information of the BTLP

As at July 31,		**2015**		**2014**
Assets				
Cash	$	517,509	$	63,851
Other current assets		29,349		153,419
Property and equipment		43,788,508		36,552,212
	$	44,335,366	$	36,769,482
Liabilities				
Current liabilities	$	7,575,024	$	1,592,418
Decommissioning obligations		538,327		27,902
Deferred income tax liability		188,276		-
	$	8,301,627	$	1,620,320

For the six months ended July 31,		**2015**		**2014**
Revenue	$	71,952	$	168,116
Direct operating costs				
Production and operating		114,888		154,406
Depreciation and depletion		65,920		81,811
Operating loss		(108,856)		(68,101)
Other expenses		103,139		116,696
Accretion		-		-
Impairment		-		-
Loss before income taxes		(211,995)		(184,797)
Deferred income tax expense		-		-
Net loss and comprehensive loss for the period	$	(211,995)	$	(184,797)

The Company has recast comparative information as at July 31, 2014 for the investment in partnership, to present the functional currency of BTLP as USD. As a result, the investment in partnership and translation reserve increased by $906,950. The recast of comparative information had no impact on cash flows and net loss, except for comprehensive loss.

6. 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 $848,130 at July 31, 2015 (January 31, 2015 - $475,797).

(Expressed in United States Dollars)

7. EXPLORATION AND EVALUATION ASSETS

	Big Wells	STS Olmos	Cutlass	Total
Balance - January 31, 2014	**$ -**	**$ 1,231,887**	**$ -**	**$ 1,231,887**
Acquisition costs	2,350,136	97,958	-	2,448,094
Exploration and evaluation	6,743,526	12,271,878	-	19,015,404
Transfer to property and equipment		(10,216,633)	-	(10,216,633)
Expenditures during the year	9,093,662	2,153,203	-	11,246,865
Reclassified from assets held for sale (Note 4)	-	-	3,094,834	3,094,834
Impairment charge	(6,656,569)	(492,135)	-	(7,148,704)
Reclassified to assets held for sale (Note 4)	-	-	(3,094,834)	(3,094,834)
Effect of changes in foreign exchange rates	(1,075,654)	(18,494)	-	(1,094,148)
	(7,732,223)	(510,629)	-	(8,242,852)
Balance - January 31, 2015	**$ 1,361,439**	**$ 2,874,461**	**$ -**	**$ 4,235,900**
Acquisition costs				
Exploration and evaluation	594,185	7,900,492	-	8,494,677
Transfer to property and equipment	-	(6,274,850)	-	(6,274,850)
Expenditures during the year	594,185	1,625,642	-	2,219,827
Impairment charge	(3,031,109)	-	-	(3,031,109)
Effect of changes in foreign exchange rates	1,075,485	-	-	1,075,485
	(1,955,624)	-	-	(1,955,624)
Balance – July 31, 2015	**$ -**	**$ 4,500,103**	**$ -**	**$ 4,500,103**

Exploration and evaluation assets consist of the Company’s exploration activities, which are pending the determination of economic quantities of commercially producible proven reserves. A review of each exploration project by area is carried out at each reporting date to ascertain whether economical quantities of proven reserves have been discovered and whether such costs should be transferred to depletable property and equipment components. During the period ended July 31, 2015, $6,274,850 (2014 - $1,591,757) was reclassified to property and equipment.

During the year ended January 31, 2015, the Company recorded a charge of $492,135 to reflect the impairment in value on acquired acreage at the STS project, which had certain title deficiencies and are unlikely to be cured. The Company also recorded impairment on its Big Wells project in the amount of $6,656,569 related to the Price well, which did not result in any proved or probable reserves being assigned to the well after it was completed.

During the period ended July 31, 2015, the Company recorded additional impairment on its Big Wells project in the amount of $594,185 related to costs incurred on the Price well, which did not result in any proved or probable reserves being assigned to the well after it was completed. Additionally, during the period, the Company determined it is not prudent to use its resources to drill additional wells on its Big Wells project. Accordingly, the Company forfeited its rights under the farmout agreement and the Company recorded impairment expense of $2,436,924 related to the seismic data it had acquired over the acreage.

(Expressed in United States Dollars)

8. PROPERTY AND EQUIPMENT

Cost	Other Equipment	Leaseholds	Oil and Gas	Total
Balance – January 31, 2014	**$ 163,907**	**$ 129,106**	**$ 15,911,760**	**$ 16,204,773**
Additions	27,976	-	-	27,976
Transfer from exploration and evaluation	-	-	10,216,633	10,216,633
Change in value of decommissioning obligations	-	-	337,534	337,534
Expenditures during the year	27,976	-	10,554,167	10,582,143
Reclassified from assets held for sale (Note 4)	-	-	6,154,229	6,154,229
Effect of changes in foreign exchange rates	(40,133)	-	52,484	12,351
Reclassified to assets held for sale (Note 4)	-	-	(6,154,229)	(6,154,229)
Balance – January 31, 2015	**$ 151,750**	**$ 129,106**	**$ 26,518,411**	**$ 26,799,267**
Additions				
Transfer from exploration and evaluation	-	-	6,274,850	6,274,850
Change in value of decommissioning obligations	-	-	36,927	36,927
Expenditures during the year	-	-	6,311,777	6,311,777
Effect of changes in foreign exchange rates	(4,278)	(3,639)	(153,878)	(161,795)
Balance – July 31, 2015	**$ 147,472**	**$ 125,467**	**$ 32,676,310**	**$ 32,949,249**
Accumulated depreciation and depletion				
Balance – January 31, 2014	**$ 31,988**	**$ 13,800**	**$ 2,493,330**	**$ 2,539,118**
Reclassified from assets held for sale (Note 4)	-	-	1,454,739	1,454,739
Charge for year	51,304	24,769	4,016,980	4,093,053
Reclassified to assets held for sale (Note 4)	-	-	(1,542,534)	(1,542,534)
Effect of changes in foreign exchange rates	(10,207)	(4,727)	(1,998,414)	(2,013,348)
Balance – January 31, 2015	**$ 73,085**	**$ 33,842**	**$ 4,424,101**	**$ 4,531,028**
Charge for year	22,294	11,067	3,639,360	3,672,721
Effect of changes in foreign exchange rates	1,284	1,465	-	2,749
Balance – July 31, 2015	**$ 96,663**	**$ 46,374**	**$ 8,063,461**	**$ 8,206,498**
Net book value				
Balance – January 31, 2015	**$ 78,665**	**$ 95,264**	**$ 22,094,310**	**$22,268,239**
Balance – July 31, 2015	**$ 50,809**	**$ 79,093**	**$ 24,612,849**	**$24,742,751**

9. CREDIT FACILITY

On June 6, 2014, Terrace STS, LLC ("Terrace STS") a wholly-owned subsidiary of the Company, entered into a senior unsecured term credit facility (the "Credit Facility"), which is non-recourse to Terrace Energy Corp, to fund the development of its STS Olmos Project in McMullen and LaSalle counties in south Texas. At inception, the aggregate amount of the Credit Facility was $75 million, of which $50 million was available to be drawn at the Company's discretion. The original term of the facility is four years with cash interest of LIBOR (with a floor of 1%) plus 7% plus accrued principal ("PIK") interest of 5% per annum. Cash interest to be paid monthly; principal and PIK interest paid upon maturity on May 31, 2018. Early repayment is permitted under certain conditions.

(Expressed in United States Dollars)

9. CREDIT FACILITY (Continued)

During the year ended January 31, 2015, the Company made an initial draw of $25 million and received net proceeds of $24 million after deducting the agreed-upon transaction cost of $1 million. The Company also incurred $1.4 million of legal and other additional costs, which has been netted against the balance outstanding under the facility and will be amortized into interest expense over the life of the credit facility.

Balance at January 31, 2014	$	-
Draws		25,000,000
Financing costs incurred		(2,438,116)
Amortization of financing costs		280,006
PIK interest		609,955
Effect of changes in foreign exchange rates		(602)
Balance at January 31, 2015	$	23,451,243
Financing costs incurred		(70,302)
Amortization of financing costs		(166,996)
PIK interest		650,585
Balance at July 31, 2015	$	23,864,530

The Company is restricted from utilizing funds drawn under the Credit Facility or funds generated from the operations of its STS Olmos Project for anything other than for operating costs and ongoing development activities at the STS Olmos Project. At July 31, 2015, the Company had $4,478,762 of restricted funds for its STS Olmos Project. The terms of the Credit Facility also provides for certain other covenants including the requirement to maintain certain financial condition covenants. The financial condition covenants consist of the quarter-end requirement to maintain an asset coverage ratio of 1.25 to 1, to maintain a current ratio of 1 to 1 and a leverage ratio that limits the amount of debt outstanding relative to EBITDA ranging from 2 to 1 up to 3.25 to 1 depending on the period.

As at January 31, 2015, the Company was not in compliance with the asset coverage ratio and the leverage ratio covenants pursuant to the agreement. During May 2015, the lender provided the Company a waiver of the non-compliance at January 31, 2015 and for the expected non-compliance for the quarter ending April 30, 2015. In addition, the lender agreed to adjust the asset coverage ratio to 5.5 to 1, 4.2 to 1 and 3.6 to 1 at July 31, 2015, October 31, 2015 and January 31, 2016, respectively, and to adjust the leverage ratio requirement to 0.9 to 1, 0.9 to 1 and 0.95 to 1 at July 31, 2015, October 31, 2015 and January 31, 2016, respectively. As a condition of the waivers and reset of the covenants granted by the lender, the Company agreed to increase the interest rate margin from 7% to 8% beginning June 1, 2016 and to pledge the assets of Terrace STS as collateral to the Credit Facility. In addition, the Company agreed to reduce the amount available to be drawn under the facility to the $25 million that is currently outstanding. The remaining undrawn amounts under the Credit Facility may be made available to the Company, at the Lender's discretion, depending upon project performance and market conditions The Company also agreed to advance to Terrace STS, LLC any proceeds received from the sale of the Cutlass oil and gas assets. Finally, the Company also agreed to devise a plan acceptable to the lender to enhance the overall capitalization of the Terrace STS, LLC entity by August 31, 2015. The Company and its financial advisor continue to evaluate financial options and strategic alternatives which would ultimately result in an enhanced capitalization of the Terrace STS, LLC. The Company is in ongoing discussions with its lender to ensure such contemplated plans are satisfactory to the lender.

The following assets of Terrace STS were pledged at July 31, 2015:

Cash	$	4,478,762
Accounts receivable		1,436,081
Advances for future exploration		857,719
Exploration and evaluation assets		4,500,103
Property and equipment		24,729,800
	$	36,002,465

(Expressed in United States Dollars)

10. CONVERTIBLE NOTES

During the year ended January 31, 2014, 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 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 held a special meeting of the holders of its notes on October 8, 2013 and obtained approval for an arrangement under the *Business Corporations Act* (British Columbia) pursuant to which all of the issued and outstanding notes would be exchanged for new 8% convertible unsecured notes of the Company due April 2, 2018 and governed by a trust indenture (the "New Notes"). The Supreme Court of British Columbia granted a final order approving the exchange, and on October 15, 2014 the Notes were exchanged for the New Notes. The New Notes have substantially similar economic terms as the Notes, including the same interest rate, maturity date and conversion price. Each note holder received an equal principal amount of New Notes under the arrangement as it presently holds notes. The New Notes are listed for trading on the Exchange.

The Company has the right to convert all or part of the New Notes into common shares at any time after April 2, 2014 if the market price of the common shares on 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 New Notes at any time after April 2, 2015 by offering cash equal to 1.00 multiplied by the principal amount that is called for redemption.

Holders of the New 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.

At July 31, 2015, CAD $38,590,000 (2014 - CAD $38,825,000) of the New Notes were outstanding and convertible into 19,295,000 (2014 – 19,412,500) common shares.

The following table reconciles the carrying amount from January 31, 2014 through July 31, 2015:

	Liability	Equity	Total
Balance, January 31, 2014	**$ 31,285,052**	**$ 2,829,976**	**$ 34,115,028**
Net accretion of discount	599,305	-	599,305
Conversion to common shares	(168,272)	(15,803)	(184,075)
Effect of changes in foreign exchange rates	(3,871,429)	-	(3,871,429)
Balance, January 31, 2015	**$ 27,844,656**	**$ 2,814,173**	**$ 30,658,829**
Net accretion of discount	314,927	-	314,927
Effect of changes in foreign exchange rates	(784,833)	-	(784,833)
Balance, July 31, 2015	**$ 27,374,750**	**$ 2,814,173**	**$ 30,188,923**

(Expressed in United States Dollars)

11. DECOMMISSIONING 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, 2014	**$**	**102,008**
Change in value of decommissioning obligations		337,534
Accretion expense		14,296
Effect of changes in foreign exchange rates		20,419
Balance, January 31, 2015	**$**	**474,257**
Change in value of decommissioning obligations		36,927
Accretion expense		5,378
Effect of changes in foreign exchange rates		17,736
Balance, July 31, 2015	**$**	**534,298**

12. CAPITAL STOCK

The Company has unlimited authorized common shares without par value. At July 31, 2015, the Company has 87,844,321 (January 31, 2015 – 87,844,321) shares outstanding.

Share issues

During the six months ended July 31, 2015, the Company did not issue any common shares.

During the year ended January 31, 2015, the Company issued:

a) 12,443,000 common shares for gross proceeds of CAD $23,019,550 at a price of CAD $1.85 per share via a short form prospectus. Share issue costs of CAD $1,774,407, which include CAD $1,496,271 of agents' fees, were paid in connection with the public offering.

b) 117,500 common shares on the conversion of CAD $235,000 convertible notes.

c) 850,000 common shares for proceeds of CAD $153,000 on the exercise of 850,000 warrants at an exercise price of CAD $0.18 per warrant.

d) 4,935,000 common shares for gross proceeds of CAD $10,610,250 at a price of CAD $2.15 per share via a short form prospectus. Share issue costs of CAD $980,508, which include $636,615 of agents' fees, were paid in connection with the public offering.

Restricted share units

The Company has a restricted share unit plan (the "RSU Plan") that permits the issuance of an aggregate of 3,682,182 RSUs to eligible participants, as described in the RSU Plan. RSUs do not confer on the holder any right to vote at a meeting of the shareholders of the Company. Common shares reserved for issuance under outstanding RSUs must be included in the calculation of common shares remaining available for reservation pursuant to options granted under the 10% rolling Option Plan. The number of common shares reserved for issuance, together with any other compensation arrangements, to any one person in any twelve-month period will not exceed 5% of the issued and outstanding common shares. The number of common shares reserved for issuance together with any other compensation arrangements granted to all technical consultants will not exceed 2% of the issued and outstanding

12. CAPITAL STOCK (Continued)

Restricted share units (Continued)

common shares. The number of RSUs granted to any one person cannot exceed 5% of the issued and outstanding common shares.

The Company has issued 1,200,000 RSUs. Each RSU, upon vesting, gives the holder the right to receive one common share. Unless otherwise approved by the Company's Board of Directors, all of the RSUs will vest upon the occurrence of a "change of control transaction", as such term is defined in the RSU award agreements. In the absence of a change of control transaction or other acceleration of vesting by the Company's Board of Directors, unvested RSUs will expire five years from the date of grant. Vested RSUs will be settled, at the election of the Company, by way of: (i) issuance of common shares from treasury; (ii) payment to the RSU holder of an amount of cash equal to the market price of the common shares on the vesting date; or (iii) any combination thereof.

The Company recognizes compensation expense for the expected number of RSUs expected to vest over the vesting period. As of July 31, 2015, there are no contemplated transactions that would give rise to vesting; therefore, no compensation expense has been recognized.

Convertible notes

As at July 31, 2015, the Company had issued and outstanding convertible notes with a face value of CAD $38,590,000 convertible into 19,295,000 common shares. At July 31, 2014, the Company had issued and outstanding convertible notes with a face value of CAD $38,640,000 convertible into 19,320,000 common shares (Note 10).

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 shares reserved 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 ten years from the date of grant. Vesting terms vary and will be determined at the time of grant by the Board of Directors.

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 $3,072 for the period ended July 31, 2015 (2014 - $99,951) with a corresponding credit to reserves. These amounts represent the value of options vested during the years.

(Expressed in United States Dollars)

12. CAPITAL STOCK (Continued)

Outstanding stock options and warrants

Stock option transactions and the number of stock options outstanding as at July 31, 2015 are summarized as follows:

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	.89
250,000	250,000	$ 0.19	July 15, 2016	.96
250,000	250,000	$ 0.21	September 16, 2016	1.10
250,000	250,000	$ 0.19	October 18, 2016	1.22
250,000	250,000	$ 0.67	December 16, 2016	1.38
150,000	150,000	$ 1.35	July 8, 2017	1.94
2,800,000	2,800,000			1.05

The weighted average exercise price of the outstanding stock options at July 31, 2015 is CAD $0.26 (January 31, 2015 - CAD $0.27). There have been no stock options granted during the six months ended July 31, 2015 and during year ended January 31, 2015. There were 100,000 options that expired during the six months ended July 31, 2015, nil during the year ended January 31, 2015.

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, 2014	1,350,000	$ 0.18	June 21, 2016
Exercised	(850,000)	$ 0.18	
Balance – January 31, 2015 and July 31, 2015	500,000	$ 0.18	June 21, 2016

13. FINANCING EXPENSES

	Six months ended July 31, 2015	2014
Interest expense	$ 2,323,766	$ 1,427,024
Accretion of convertible notes	314,927	340,618
Amortization of financing costs	(166,996)	-
PIK interest	650,585	-
Other	76,215	-
Total	$ 3,198,497	$ 1,767,642

14. 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, liabilities associated with assets held-for-sale, credit facility and convertible notes– 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, accounts payable and accrued liabilities, and liabilities associated with assets held-for-sale 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. The Company has no balances past due or impaired.

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.

(ii) Interest rate risk (Continued)

The Company is exposed to interest rate risk on its credit facility whereby interest is based on LIBOR.

(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 functional currency is CAD and its subsidiaries functional currencies are CAD USD. Transactions relating to its oil and gas properties are in USD. Therefore, the Company is impacted by changes in the exchange rate between the Canadian and US dollars.

(Expressed in United States Dollars)

14. FINANCIAL INSTRUMENTS (Continued)

Market risk (Continued)

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

	July 31, 2015 (USD)	January 31, 2015 (USD)
Cash	$ 5,730,157	$ 25,251,968
Accounts receivable	-	1,439,871
Operators bond	25,000	25,000
Accounts payable and accrued liabilities	(252,065)	(4,530,587)
Credit facility	-	(25,609,954)
Net	$ 5,503,092	$ (3,423,702)

Based on the above net exposure as at July 31, 2015, a 5% change in the Canadian/US exchange rate would impact the Company's net loss and comprehensive loss by approximately $275,155 (January 31, 2015 - $171,185). The assets and liabilities with exposure to foreign currency risk are those which are denominated in a different currency than the currency determined to the functional currency of the respective entity as of the end of the period.

(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 July 31, 2015, the Company had cash of $10,434,804 accounts receivable of $1,492,011, current liabilities of $1,308,026 amounts outstanding under the Credit Facility of $26,260,540 and convertible notes outstanding totaling CAD $38,590,000. The current liabilities are due within three months of year-end, and the Credit Facility and convertible notes mature May 31, 2018 and April 2, 2018, respectively.

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.

(Expressed in United States Dollars)

14. FINANCIAL INSTRUMENTS (Continued)

Classification of financial instruments

The following table sets forth the Company's financial assets and financial liabilities measured at fair value by level within the fair value hierarchy as at July 31, 2015.

	Level 1	Level 2	Level 3
Cash	$ 10,434,804	$ -	$ -
Credit facility	(26,260,540)	-	-
Convertible notes	-	-	(29,503,058)
	$ (15,825,736)	$ -	$ (29,503,058)

The following table sets forth the Company's financial assets and financial liabilities measured at fair value by level within the fair value hierarchy as at January 31, 2015.

	Level 1	Level 2	Level 3
Cash	$ 26,494,024	$ -	$ -
Credit facility	(25,609,954)	-	-
Convertible notes	-	-	(30,358,753)
	$ 884,070	$ -	$ (30,358,753)

15. CAPITAL DISCLOSURES

The Company considers its capital under management to be shareholders' equity, convertible notes and Credit Facility. 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, 2015. As at July 31, 2015, the Company is not subject to any externally imposed capital requirements; however, the Credit Facility is subject to certain restrictions (see Note 9).

16. COMMITMENTS

The Company has a commitment to make monthly rental payments pursuant to an office rental agreement in Vancouver, British Columbia, which commenced 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.

Total rent expense included in the condensed consolidated statements of operations and comprehensive loss for the period ended July 31, 2015 amounted to $90,057 (2014 - $23,142).

The Company is required to pay interest, calculated at 8% per annum, on outstanding convertible notes at the end of each fiscal quarter (Note 10). The Company has estimated that it must pay approximately CAD $800,000 each quarter subsequent to July 31, 2015 until the notes are converted or repaid.

(Expressed in United States Dollars)

16. COMMITMENTS (Continued)

The Company has interests in certain exploration and evaluation assets, which are subject to certain expenditure commitments (Notes 5 and 7).

During the year ended January 31, 2015, the Company acquired non-proprietary 3-D seismic data over its Big Wells project at a cost of approximately $2.3 million as part of a multi-year commitment to purchase additional 3-D seismic data at a volume discounted value of approximately $4.7 million over the next two years. The additional data is to be selected at the Company's discretion to aid in the evaluation of the expansion of its existing projects (including offsetting acreage surrounding its STS Olmos Project) and/or new projects developed over the next two years. Under the current agreement, the Company is committed to purchase additional data in each of 2015 and 2016 at a cost of $2,362,500 per year; however, the Company is currently reassessing its development plans, timing and data requirements in light of the current commodity price environment. The Company has initiated discussions with the provider to restructure this agreement and eliminate any commitments to purchase additional data. There can be no assurances that these discussions will result in modifying the existing agreements, including the remaining commitments of the Company to purchase additional data.

During April 2015, the Company entered into agreements, through a wholly-owned subsidiary, to earn a 75% working interest and a 52.5% net revenue interest, as to the Olmos formation only, in certain leases covering initially 640 gross mineral acres in LaSalle County, Texas. Under the terms of these agreements, the Company is required to commence drilling a well (paying 100% of the cost) on this acreage by late September 2015 or pay liquidated damages of $500,000. Due to the current market conditions, the Company has initiated discussions with the farmor to obtain more time to drill and complete the well. There are no assurances the Company will secure an agreement to allow for additional time to drill the well on terms acceptable to the Corporation or on any terms.

17. 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:

	Period ended July 31, 2015	2014
Short-term compensation	$ 720,909	$ 619,689
Share-based payments	1,536	44,829
	$ 722,445	$ 664,518

Included in accounts receivable as at July 31, 2015 are advances to key management personnel totaling $47,562 January 31, 2015 - $47,562) for expenses incurred by the Company on their behalf.

At July 31, 2015, convertible notes held by key management personnel and their close family members totalled CAD $3,230,000 (January 31, 2015 - CAD $3,230,000). Interest paid these convertible notes totalled CAD $128,138 during the period (2014 - $125,576).

All related party amounts included in accounts receivable and accounts payable and accrued liabilities are due on demand.

18. SUPPLEMENTAL CASH FLOW INFORMATION

During the period ended July 31, 2015, the Company:

a) transferred $6,274,850 from exploration and evaluation assets to property and equipment;

b) had accounts payable and accrued liabilities of $611,839 related to exploration and evaluation expenditures; and

c) paid $2,323,766 of interest, received $nil of interest and paid $nil income taxes.

During the period ended July 31, 2014, the Company:

a) transferred $1,591,757 from exploration and evaluation assets to property and equipment;

b) transferred $11,140 from equity reserves to capital stock on the exercise of warrants;

c) transferred $153,729 from the liability component of convertible notes and $5,059 from the equity component of convertible notes to capital stock on the conversion of convertible notes; and

d) had accounts payable and accrued liabilities of $1,160,184 related to exploration and evaluation expenditures.