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

FOR THE NINE AND THREE MONTHS ENDED OCTOBER 31, 2014 and 2013

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

December 30, 2014

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

	October 31, 2014	January 31, 2014
ASSETS		
Current assets		
Cash	$ 34,823,565	$ 11,097,174
Accounts receivable (Note 16)	919,947	1,939,538
Prepaids	223,027	135,361
Assets held for sale (Note 4)	-	10,000,000
Total current assets	35,966,539	23,172,073
Non-current assets		
Operator's bond	25,000	25,000
Deferred financing costs (Note 9)	701,412	-
Investment in partnership (Note 5)	18,438,222	15,681,920
Advances for future exploration (Note 6)	480,874	87,152
Exploration and evaluation assets (Note 7)	14,831,196	1,231,887
Property and equipment (Note 8)	18,649,028	13,665,655
Total assets	$ 89,092,271	$ 53,863,687
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	$ 948,970	$ 1,063,367
Liabilities associated with assets held for sale (Note 4)	-	56,151
Total current liabilities	948,970	1,119,518
Non-current liabilities		
Credit facility (Note 9)	23,565,557	-
Convertible notes (Note 10)	31,216,315	31,285,052
Decommissioning obligations (Note 11)	160,302	102,008
Total liabilities	55,891,144	32,506,578
Shareholders' equity		
Capital stock (Note 12)	47,443,094	27,421,256
Convertible notes – equity component (Note 10)	2,813,924	2,829,976
Stock options reserve (Note 12)	1,054,073	924,942
Warrants reserve (Note 12)	6,099	17,239
Translation reserve (Note 2)	(3,163,858)	(1,732,922)
Deficit	(14,952,205)	(8,103,382)
Total shareholders' equity	33,201,127	21,357,109
Total liabilities and shareholders' equity	$ 89,092,271	$ 53,863,687

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 nine months ended October 31, 2014	For the nine months ended October 31, 2013	For the three months ended October 31, 2014	For the three months ended October 31, 2013
REVENUE				
Oil and gas sales (net of royalties)	$ 5,286,246	$ 2,869,536	$ 1,240,376	$ 1,321,384
DIRECT OPERATING EXPENSES				
Production and operating	1,490,255	331,978	530,849	82,664
Depreciation, depletion and accretion (Notes 4, 8 and 10)	3,259,393	1,159,040	1,847,423	665,509
Operating income	536,598	1,378,518	(1,137,896)	573,211
Equity income (loss) in partnership (Note 5)	(138,679)	137,662	(52,776)	101,753
	397,919	1,516,180	(1,190,672)	674,964
GENERAL AND ADMINSTRATIVE EXPENSES				
Administrative	545,038	626,870	114,455	270,195
Foreign exchange (gain) loss	(1,083,466)	(197,017)	(702,667)	564,034
Impairment (Note 4 and 7)	2,082,295	-	2,100,760	-
Interest (Note 10)	3,358,197	1,959,514	1,590,555	926,389
Investor relations	296,758	318,507	153,561	127,702
Professional	529,212	514,597	183,633	348,329
Salaries and benefits (Note 16)	1,225,752	644,817	473,683	240,208
Share-based payments (Notes 12 and 16)	129,131	368,654	29,180	64,460
Transfer agent and filing fees	94,286	50,705	50,181	(2,795)
Travel	69,539	164,390	13,443	34,903
	7,246,742	4,451,037	4,006,784	2,573,425
Net loss for the period	(6,848,823)	(2,934,857)	(5,197,456)	(1,898,461)
Other comprehensive loss				
Items that may be reclassified subsequently to profit or loss:				
Cumulative translation adjustment	(1,430,936)	(672,217)	(1,341,971)	(78,523)
Comprehensive loss for the period	$ (8,279,759)	$ (3,607,074)	$ (6,539,427)	$ (1,976,984)
Basic and diluted loss per share	$ (0.09)	$ (0.05)	$ (0.06)	$ (0.03)
Weighted average number of common shares outstanding	79,753,271	63,104,724	87,834,404	63,160,710

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, 2013	**63,069,321**	**$ 15,977,713**	**$ -**	**$ 638,649**	**$ 255,342**	**$ 396,149**	**$ (1,527,890)**	**$ 15,739,963**
Convertible notes - equity components	-	-	2,912,679	-	-	-	-	2,912,679
Exercise of convertible notes	100,000	184,179	(14,377)	-	-	-		169,802
Exercise of warrants	4,062,500	701,196	-	-	-	-		701,196
Fair value of warrant exercises	-	168,766	-	-	(168,766)	-		-
Share-based payments	80,000	140,000	-	228,654	-	-	-	368,654
Cumulative translation adjustment	-	-	-	-	-	(672,217)	-	(672,217)
Net loss for the period	-	-	-	-	-	-	(2,934,857)	(2,934,857)
Balance – October 31, 2013	**67,311,821**	**$ 17,171,854**	**$ 2,898,302**	**$ 867,303**	**$ 86,576**	**$ (276,068)**	**$ (4,462,747)**	**$ 16,285,220**
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		(1,617,969)	-	-	-	-	-	(1,617,969)
Exercise of convertible notes	117,500	210,966	(16,052)	-	-	-	-	194,914
Exercise of warrants	850,000	138,429	-	-	-	-	-	138,429
Fair value of warrant exercises	-	11,140	-	-	(11,140)	-	-	-
Share-based payments	-	-	-	129,131	-	-	-	129,131
Cumulative translation adjustment	-	-	-	-	-	(1,430,936)	-	(1,430,936)
Net loss for the period	-	-	-	-	-	-	(6,848,823)	(6,848,823)
Balance – October 31, 2014	**87,844,821**	**$ 47,443,094**	**$ 2,813,924**	**$ 1,054,073**	**$ 6,099**	**$ (3,163,858)**	**$ (14,952,205)**	**$ 33,201,127**

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

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the period	$ (6,848,823)	$ (2,934,857)
Items not involving cash:		
Accretion of convertible notes	500,450	390,240
Depreciation, depletion and accretion	3,259,393	1,159,040
Equity (income) loss in partnership	138,679	(137,662)
Impairment of exploration and evaluation assets	2,082,295	-
Share-based payments	129,131	368,654
Non-cash interest expense	285,485	
Unrealized (gain) loss on foreign exchange	(258,833)	156,661
Changes in non-cash working capital items:		
Accounts receivable	1,019,591	175,358
Prepaids	(87,666)	(39,463)
Accounts payable and accrued liabilities	(711,981)	938,266
Net cash provided by operating activities	(492,279)	76,237
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to exploration and evaluation assets	(14,592,406)	(17,008,528)
Advances for future exploration	(442,278)	(2,777,426)
Acquisition of property and equipment	(24,977)	(226,526)
Investment in partnership	(3,138,000)	(13,624,066)
Net cash used in investing activities	(18,197,661)	(33,636,546)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from issuance of shares	19,661,303	-
Proceeds from credit facility (net of original issue discount)	24,000,000	-
Financing costs	(1,438,116)	-
Exercise of warrants	138,429	701,196
Net proceeds from issuance of convertible notes	-	36,770,202
Net cash provided by financing activities	42,361,616	37,471,398
Foreign exchange effect on cash	54,715	(72,068)
Change in cash for the period	23,726,391	3,839,021
Cash, beginning of the period	11,097,174	1,673,449
Cash, end of the period	$ 34,823,565	$ 5,512,470

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's head office is located at 1012-1030 West Georgia Street, Vancouver, British Columbia, Canada V6E 2Y3. It's 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 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, 2014. 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, 2014. The policies applied in these condensed consolidated interim financial statements are based on IFRS issued and outstanding as of October 31, 2014.

The Board of Directors approved the unaudited condensed consolidated interim financial statements on December 30, 2014.

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. 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 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.

Carrying value of property and equipment and exploration and evaluation assets

The Company assesses at each reporting date whether there is an indication that an asset or cash-generating unit ("CGU") may be impaired. 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. If any indication exists that an asset or CGU may be impaired, the Company estimates the recoverable amount. The recoverable amounts of individual assets and CGUs have been determined based on the higher of value-in-use calculations and fair value less costs to sell. These calculations require the use of estimates and assumptions, such as estimates of proved plus probable reserves, future production rates, oil and natural gas prices, future costs and other relevant assumptions, all of which are subject to change.

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.

Assets held for sale

Judgment is required in determining whether an asset meets the criteria for classification as "assets held for sale" in the 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 balance sheet 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.

(Expressed in United States Dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Principles of consolidation

These condensed consolidated interim 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 LLC	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%

Deferred financing costs

Deferred financing costs represent the unamortized financing costs paid to secure borrowings. Amortization is provided on an effective yield basis over the term of the related debt and is included in expenses for the period. Unamortized deferred financing costs are offset against the respective liability accounts.

4. ASSETS HELD FOR SALE

During the fiscal year ended January 31, 2014, the Company funded all of the costs necessary to earn its working interests in the properties that comprise the Cutlass project. The appropriate assignments of working interest were received by the Company for each of the leases and have been filed on record in the counties of LaSalle and Dimmitt, TX.

Upon completing a project review in October 2013, management determined that Cutlass was no longer a core asset and decided to solicit bids from prospective purchasers. A data room was established and the Company continues to entertain purchase offers and other proposals for development of these leases.

The Company previously determined that the proposed sale met the definition of "assets held for sale", under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, and therefore reclassified the various assets and liabilities associated with the Company's interests in Cutlass to "assets held for sale" and "liabilities associated with assets held for sale".

Although it is still the intent of the Company to sell its interest in Cutlass, IFRS 5 prescribes that "assets held for sale" must be sold within twelve month or reclassified. The Company was unable to sell Cutlass by October 31, 2014 and therefore reclassified the assets back to the appropriate balance sheet classifications as follows:

(Expressed in United States Dollars)

4. ASSETS HELD FOR SALE (continued)

Assets held for sale:

Balance January 31, 2014	$	10,000,000
Changes during the period:		
Recovery of advances, net		341,407
Effect of foreign exchange		384,877
Assets held for sale prior to reclassification		10,726,284
Depletion (November 1, 2013 to October 31, 2014)		(1,372,906)
Impairment as of October 31, 2014		(1,559,054)
Reclassified to:		
Exploration and evaluation assets (Note 7)		(3,094,834)
Property and equipment (Note 8)		(6,154,229)
Accumulated depreciation and depletion (Note 8)		1,454,739
Balance October 31, 2014	$	-

During the twelve month period ended October 31, 2014, during which the Cutlass assets were classified as assets held for sale, the project generated operating income of $573,475, comprising revenues and expenses of $1,231,056 and $657,581, respectively. As a result of the reclassifications, the Company recorded additional depletion expense of $1,372,906 to reflect the depletion that would have been recorded had the Cutlass assets not been classified as assets held for sale. In addition, Management evaluated the Cutlass assets before reclassification, based on recent expressions of interest from potential acquirers, and remeasured them at $7,794,324, resulting in an impairment charge during the period of $1,559,054.

In August, 2014, the project operator made a spurious claim that the Company did not meet its obligations and demanded it reassign its interests in the leases. The Company considers this claim to be without merit and has taken appropriate legal action in LaSalle County, TX to establish clear ownership of its title to these leases. Until such matter is resolved, the Company expects to experience difficulty in successfully marketing the sale of its interest in the Cutlass Project.

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 “SPLP”), to acquire a 50% working interest in certain oil and gas leases in Maverick County, Texas, (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 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;

(Expressed in United States Dollars)

5. INVESTMENT IN PARTNERSHIP (continued)

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

3. upon making the Carry Payment in full, the SPLP shall have the option, but not the obligation, to pay 50% of all development costs for the right to participate in at least 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 this period, the SPLP successfully renegotiated the drilling obligations under the farmout agreement to amend the targets and timing of future wells necessary to fulfill the remaining earning requirements. Under the revised agreement, the SPLP now has the flexibility to choose locations, set objectives and govern the timing of operations under a blanket requirement to spend $25 million per year ($12.5 million net to Terrace) commencing at January 1, 2015 until the total required drilling obligation of $104 million has been spent. The SPLP has spent approximately $32 million to-date towards the aggregate drilling obligation. The SPLP is obligated to pay liquidated damages equal to $2 million ($1 million net to Terrace) in the event that the minimum annual expenditure is not met in a particular year.

The carrying value of $18,438,222 at October 31, 2014 (January 31, 2014 - $15,681,920), which represents the Companies 50% share of advances to the partnership offset by the Companies respective share of changes in net assets of the partnership to date. The advances which total $18,524,848, represent the Company's share of costs to organize, acquire and fund certain agreed upon exploration and evaluation activities to date.

Summary of financial information of the SPLP

As at September 30, 2014		**2014**
		(unaudited)
Assets		
Current assets	$	453,294
Fixed assets		36,687,969
	$	37,141,263
Liabilities		
Current liabilities	$	391,114
Decommissioning obligations		27,902
	$	419,016

For the nine months ended September 30, 2014		**2014**
		(unaudited)
Revenue	$	253,407
Operating and other expenses		(517,922)
Net loss for the period	$	(264,515)

(Expressed in United States Dollars)

5. INVESTMENT IN PARTNERSHIP (continued)

These amounts are as disclosed on the SPLP interim financial statements as of September 30, 2014 and includes nine months of net loss amounts since the partnership has a December 31 calendar year-end. These amounts do not show the effect of foreign exchange translation necessary to reconcile to the amounts shown in the Company's financial statements.

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 $480,874 related to our development activities at our STS Olmos project ($428,559 at January 31, 2014 of which $341,407 was reclassified to assets held for sale, which was recovered during the second quarter (Note 4)).

7. EXPLORATION AND EVALUATION ASSETS

	Big Wells	STS Olmos	Cutlass	Total
Balance - January 31, 2013	**$ -**	**$ 970,939**	**$ 5,766,100**	**$ 6,737,039**
Acquisition costs	-	497,430	1,670,281	2,167,711
Exploration and evaluation	-	10,302,922	7,269,863	17,572,785
Transfer to property and equipment	-	(10,353,308)	(9,784,136)	(20,137,444)
Net expenditures during the year	-	447,044	(843,992)	(396,948)
Effect of changes in foreign exchange rates	-	(186,096)	(408,987)	(595,083)
Reclassified to assets held for sale (Note 4)	-	-	(4,513,121)	(4,513,121)
	-	(186,096)	(4,922,108)	(5,108,204)
Balance - January 31, 2014	**-**	**1,231,887**	**-**	**1,231,887**
Exploration and evaluation	7,086,945	8,046,894	-	15,133,839
Transfer to property and equipment	-	(1,591,757)	-	(1,591,757)
Net expenditures during the year	7,086,945	6,455,137	-	13,542,082
Impairment charge	-	(456,165)	-	(456,165)
Effect of changes in foreign exchange rates	(1,229,787)	(1,351,655)	-	(2,581,442)
Reclassified from assets held for sale	-	-	3,094,834	3,094,834
	(1,229,787)	(1,807,820)	3,094,834	57,227
Balance - October 31, 2014	**$ 5,857,158**	**$ 5,879,204**	**$ 3,094,834**	**$ 14,831,196**

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 October 31, 2014, $1,591,757 (January 31, 2014 - $20,137,444) was reclassified to property and equipment.

(Expressed in United States Dollars)

7. EXPLORATION AND EVALUATION ASSETS (continued)

During the period, the Company recorded a $456,165 charge against exploration and evaluation assets to reflect the impairment in value of certain acreage associated with our STS project once it was determined there were title deficiencies that are unlikely to be cured.

8. PROPERTY AND EQUIPMENT

Cost	Other Equipment	Leaseholds	Oil and Gas	Total
Balance – January 31, 2013	**$ 63,597**	**$ -**	**$ 6,828,215**	**$ 6,891,812**
Additions	121,725	138,038	-	259,763
Transfer from exploration and evaluation	-	-	20,137,444	20,137,444
Change in value of decommissioning obligations	-	-	99,605	99,605
Net expenditures during the year	121,725	138,038	20,237,049	20,496,812
Effect of changes in foreign exchange rates	(21,415)	(8,932)	(2,178,940)	(2,209,287)
Reclassified to assets held for sale (Note 4)	-	-	(8,974,564)	(8,974,564)
Balance – January 31, 2014	**163,907**	**129,106**	**15,911,760**	**16,204,773**
Additions	24,977	-	-	24,977
Transfer from exploration and evaluation	-	-	1,591,757	1,591,757
Change in value of decommissioning obligations	-	-	71,972	71,972
Net expenditures during the year	24,977	-	1,663,729	1,668,706
Effect of changes in foreign exchange rates	(485)	-	274,797	274,312
Reclassified from assets held for sale (Note 4)			6,154,229	6,154,229
Balance- October 31, 2014	**$ 188,399**	**$ 129,106**	**$ 24,004,515**	**$ 24,322,020**

Accumulated depreciation and depletion	Other Equipment	Leaseholds	Oil and Gas	Total
Balance – January 31, 2013	**$ 11,274**	**$ -**	**$ 833,010**	**$ 844,284**
Charge for year	25,390	14,336	1,926,852	1,966,578
Effect of changes in foreign exchange rates	(4,676)	(536)	(184,699)	(189,911)
Reclassified to assets held for sale (Note 4)	-	-	(81,833)	(81,833)
Balance – January 31, 2014	**31,988**	**13,800**	**2,493,330**	**2,539,118**
Charge for period	44,029	12,491	1,893,125	1,949,645
Reclassified from assets held for sale	-	-	1,454,739	1,454,739
Effect of changes in foreign exchange rates	(1,352)	(383)	(268,775)	(270,510)
Balance – October 31, 2014	**$ 74,665**	**$ 25,908**	**$ 5,572,419**	**$ 5,672,992**

Net book value	Other Equipment	Leaseholds	Oil and Gas	Total
Balance – January 31, 2014	**$ 131,919**	**$ 115,306**	**$ 13,418,430**	**$ 13,665,655**
Balance – October 31, 2014	**$ 113,734**	**$ 103,198**	**$ 18,432,096**	**$ 18,649,028**

(Expressed in United States Dollars)

9. CREDIT FACILITY

On June 6, 2014, a wholly-owned subsidiary of the Company entered into a senior unsecured term credit facility (the "Credit Facility"), which is non-recourse to Terrace, to fund the development of its STS Olmos Project in McMullen and LaSalle counties in south Texas. The aggregate amount of the Credit Facility is $75 million, of which $50 million may be drawn at the Company's discretion. The remaining $25 million will be made, at the Lender's discretion, depending upon project performance and market conditions. The term of the facility is four years with cash interest of LIBOR (with a floor of 1%) plus 7% plus payment in kind ("PIK") interest of 5% per annum. Cash interest to be paid monthly; principal and PIK interest paid upon maturity. Prepayment is permitted under certain conditions.

During the period, the Company made an initial draw of $25 million and received net proceeds of $24 million after deducting the agreed upon issue discount of $1 million. The Company also incurred $1.4 million of legal and other additional costs of which approximately one-half million has been capitalized as deferred financing costs and one-half has been netted against the balance outstanding under the facility and will be amortized into interest expense over the life of the facility.

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. 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 1:1 and a leverage ratio which 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 October 31, 2014 the Company is not in breach of any of these covenants.

Balance at January 31, 2014	$ -
Draws	25,000,000
Original Issue Discount	(1,000,000)
Financing Costs	(719,058)
PIK Interest	285,485
Effect of changes in foreign exchange rates	(870)
Balance at October 31, 2014	$ 23,565,557

10. CONVERTIBLE NOTES

In the prior fiscal year, the Company completed two non-brokered private placements of convertible, unsecured promissory notes (the "Notes") in the aggregate principal amount of CAD $40,000,000. The Notes which were due April 2, 2018, paid interest of 8% per annum and were convertible into 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 Noteholder 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, 2014 by offering cash equal to 1.08 multiplied by the principal amount that is called for

(Expressed in United States Dollars)

10. CONVERTIBLE NOTES (continued)

redemption, and 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 in certain circumstances.

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 initial face value of the debentures and the fair value of the liability component was recognized in equity at that time. Transaction costs directly attributable to the offering were allocated to the liability and equity components of the debentures proportionately. The discount on the debentures is being accreted such that the liability component will equal the face value of the debentures at maturity.

At October 31, 2014, CAD $38,590,000 of the New Notes were outstanding and convertible into 19,295,000 common shares.

The following table reconciles the fair value of the convertible debentures on initial recognition to the carrying amount at October 31, 2014:

	Liability	Equity	Total
Subscription proceeds	$ 35,355,642	$ 3,039,844	$ 38,395,486
Transaction costs	(1,498,118)	(127,165)	(1,625,283)
Net accretion of discount	530,462	-	530,462
Conversion to common shares	(945,573)	(82,703)	(1,028,276)
Effect of changes in foreign exchange rates	(2,157,361)	-	(2,157,361)
Balance, January 31, 2014	31,285,052	2,829,976	34,115,028
Net accretion of discount	500,450	-	500,450
Conversion to common shares	(194,914)	(16,052)	(210,966)
Effect of changes in foreign exchange rates	(374,273)	-	(374,273)
Balance, October 31, 2014	$ 31,216,315	$ 2,813,924	$ 34,030,239

(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.

		2014
Balance – January 31, 2013	$	8,016
Change in value of decommissioning obligations		92,247
Accretion expense		1,745
Balance – January 31, 2014		102,008
Change in value of decommissioning obligations		71,972
Accretion expense		(13,678)
Balance – October 31, 2014	$	160,302

12. CAPITAL STOCK

The Company has unlimited authorized common shares without par value. At October 31, 2014, the Company had 87,844,821 (January 31, 2014 - 74,434,321) shares outstanding.

Share issues

During the nine months ended October 31, 2014, 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.

During the year ended January 31, 2014, the Company issued:

a) 80,000 common shares with a fair value of $140,000 as partial compensation to the Chief Executive Officer ("CEO") and President of the Company.

b) 587,500 common shares on the conversion of CAD $1,175,000 convertible notes.

c) 5,762,500 common shares for proceeds of CAD $1,037,250 on the exercise of 5,762,500 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 CAD $636,615 of agents' fees, were paid in connection with the public offering.

12. CAPITAL STOCK (continued)

Restricted share units ("RSUs")

The Company has a restricted share unit 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, issue to directors, officers, employees and technical consultants to the Company, RSUs. The number of common shares of the Company that may be reserved for issuance must not exceed 4,681,982 as of October 31, 2014. In addition, common shares reserved for issuance of RSUs will reduce the number of shares that may be made subject to the incentive stock options under the Company's 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 common shares. The number of RSUs granted to any one person cannot exceed 5% of the issued and outstanding common shares.

The Company issued 1,200,000 RSUs with a value of CAD $2,991,500. 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 October 31, 2014, there are no contemplated transactions that would give rise to vesting; therefore, no compensation expense has been recognized.

Convertible notes

As at October 31, 2014, 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 January 31, 2014, the Company had issued and outstanding convertible notes with a face value of CAD $38,825,000 convertible into 19,412,500 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 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.

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 $129,131 for the period ended October 31, 2014 (2013 - $368,654), with a corresponding credit to reserves.

(Expressed in United States Dollars)

12. CAPITAL STOCK (continued)

Outstanding stock options and warrants

The following stock options were outstanding as at October 31, 2014:

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	1.64
250,000	250,000	$ 0.19	July 15, 2016	1.70
250,000	250,000	$ 0.21	September 16, 2016	1.85
250,000	250,000	$ 0.19	October 18, 2016	1.96
100,000	100,000	$ 0.53	November 25, 2016	2.07
250,000	212,500	$ 0.67	December 16, 2016	2.13
150,000	105,000	$ 1.35	July 8, 2017	2.69
2,900,000	2,817,500			1.80

The weighted average exercise price of the outstanding stock options at October 31, 2014 is CAD $0.27 (January 31, 2014 - CAD $0.27).

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, 2013	7,112,500	$ 0.18	June 21, 2016
Exercised	(5,762,500)	$ 0.18	
Balance - January 31, 2014	1,350,000	$ 0.18	June 21, 2016
Exercised	(850,000)	$ 0.18	
Balance - October 31, 2014	500,000	$ 0.18	June 21, 2016

13. FINANCIAL INSTRUMENTS

The Company has classified its financial instruments as follows:

- Cash – as FVTPL;
- Accounts receivable and operator's bond – as loans and receivables; and
- Accounts payable and accrued liabilities, liabilities associated with assets held-for-sale 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.

13. FINANCIAL INSTRUMENTS (continued)

The fair value of the operator's bond also approximates its carrying value. The debt component of the convertible notes was recognized initially at fair value and thereafter has been accounted for at amortized cost.

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.

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 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 Canadian dollars, but substantially all of the Company's operations are conducted in United States dollars. Therefore, the Company is impacted by changes in the exchange rate between the Canadian and United States dollars.

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

	October 31, 2014 (USD)	January 31, 2014 (USD)
Cash	$ 32,721,659	$ 8,595,184
Accounts receivable	876,370	1,856,863
Operator's bond	25,000	25,000
Accounts payable and accrued liabilities	(862,662)	(223,073)
Liabilities associated with assets held for sale	-	(56,151)
Net	$ 32,760,367	$ 10,197,823
Canadian dollar equivalent	CAD $ 36,760,408	CAD $ 11,358,335

13. FINANCIAL INSTRUMENTS (continued)

Based on the above net exposures as at October 31, 2014, a 5% change in the Canadian/United States exchange rate would impact the Company's net loss and comprehensive loss by approximately $1,838,000 (January 31, 2014 - $568,000).

(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 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 October 31, 2014, the Company had cash of $38,848,564, accounts receivable of $919,947 and current liabilities, due within three months, of $948,970.

In addition, the Company had outstanding convertible notes totaling CAD $38,590,000 due April 2, 2018 and $25,284,552 due under the credit facility. The term of the Credit Facility is four years with cash interest of LIBOR (with a floor of 1%) plus 7% and payment in kind ("PIK") interest of 5% per annum. Cash interest to be paid monthly and principal and PIK interest is due on maturity.

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

14. 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 these objectives.

The Company's capital management strategy has not changed from January 31, 2014. As at October 31, 2014, the Company is not subject to any externally imposed capital requirements.

15. 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, 2015 and will require total payments of $89,337 until the expiry date.

The Company has a commitment to make monthly rental payments pursuant to an office rental agreement in Vancouver, British Columbia, through June 30, 2020. The lease requires total annual payments of CAD $68,824 for the twelve months ending June 30, 2015; CAD $72,511 for the twelve months ending June 30, 2016 to 2018 and; and CAD $76,198 for the twelve months ended June 30, 2019 and 2020.

(Expressed in United States Dollars)

15. COMMITMENTS (continued)

The Company is required to pay interest monthly on its Credit Facility, calculated at LIBOR (with a floor of 1%) plus 7% per annum on its credit facility. The maturity date of the facility is May 31, 2018 at which time any unpaid principal amounts are due together with PIK interest due of 5% per annum accrued on outstanding amounts through the inception of the facility.

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 $757,000 each quarter subsequent to October 31, 2014 until the notes are converted or repaid.

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

During the period, the Company acquired nonproprietary 3-D seismic data over its Big Wells project at a cost of approximately $1.2 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 agreement allows the Company to select the additional data, at its discretion, to aid in the evaluation of existing projects and/or new projects developed.

16. 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:

	2014	2013
Short-term compensation	$ 982,176	$ 364,831
Share-based payments	131,232	150,468
	$ 1,113,408	$ 515,299

Included in accounts receivable as at October 31, 2014 are advances to key management personnel totaling $47,562 (January 31, 2014 - $47,562) for expenses incurred by the Company on their behalf.

At October 31, 2014, convertible notes held by key management personnel totalled CAD $3,040,000.

17. 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:

	October 31, 2014		
	USA	Canada	Total
Advances for future exploration	$ 480,874	$ -	$ 480,874
Deferred financing costs	701,412	-	701,412
Exploration and evaluation assets	14,831,197	-	14,831,197
Property and equipment	18,485,034	163,994	18,649,028
Investment in partnership	18,438,222	-	18,438,222
	$ 52,936,739	$ 163,994	$ 53,100,733

(Expressed in United States Dollars)

17. SEGMENTED INFORMATION (continued)

	January 31, 2014		
	USA	**Canada**	**Total**
Advances for future exploration	$ 87,152	$ -	$ 87,152
Exploration and evaluation assets	1,231,887	-	1,231,887
Property and equipment	13,418,400	247,255	13,665,655
Investment in partnership	15,681,920	-	15,681,920
	$ 30,419,359	$ 247,255	$ 30,666,614

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

18. SUPPLEMENTAL CASH FLOW INFORMATION

During the period ended October 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; and

c) transferred $226,802 from the liability component of convertible notes and $16,052 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 $674,721 related to exploration and evaluation expenditures.

During the nine months ended October 31, 2013, the Company:

a) transferred $12,459,050 from exploration and evaluation assets to property and equipment;

b) transferred $168,766 from equity reserves to share capital on the exercise of warrants;

c) transferred $169,802 from the liability component of convertible notes and $14,377 from the equity component of convertible notes to share capital on the conversion of convertible notes; and

d) had accounts payable and accrued liabilities of $950,895 (January 31, 2013 - $437,045) related to exploration and evaluation expenditures.