

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

FOR THE THREE MONTHS ENDED APRIL 30, 2017 AND 2016

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 Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditor.

Vancouver, Canada

June 20, 2017

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

	April 30, 2017	January 31, 2017
ASSETS		
Current assets		
Cash	\$ 2,218,257	\$ 2,532,786
Accounts receivable	51,421	22,014
Prepays	69,924	96,243
Total current assets	2,339,602	2,651,043
Non-current assets		
Operator's bond	25,000	25,000
Investment in partnership (Note 5)	5,088,811	5,105,697
Property and equipment (Note 6)	44,480	46,264
Total assets	\$ 7,497,893	\$ 7,831,004
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities		
Accounts payable and accrued liabilities (Note 13)	\$ 622,928	\$ 652,323
Total current liabilities	622,928	652,323
Non-current liabilities		
Convertible notes (Notes 7 and 13)	13,402,233	13,382,619
Total liabilities	14,025,161	14,034,942
Shareholders' deficit		
Capital stock (Note 8)	47,689,739	47,689,739
Convertible notes – equity component (Note 7)	2,003,196	2,003,196
Stock options reserve (Note 8)	153,375	153,375
Translation reserve (Note 2)	95,874	265,447
Deficit	(56,469,452)	(56,315,695)
Total shareholders' deficit	(6,527,268)	(6,203,938)
Total liabilities and shareholders' deficit	\$ 7,497,893	\$ 7,831,004

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 three months ended April 30

	2017	2016
Equity loss in partnership (Note 5)	\$ (16,885)	\$ (38,035)
EXPENSES		
Administrative	95,489	100,552
Business development	13,203	-
Depreciation	13,112	14,868
Financing (Note 9)	655,150	787,690
Foreign exchange gain	(770,520)	(2,197,944)
Provision for contract litigation (Note 12)	-	500,000
Investor relations	-	6,207
Professional	5,173	83,564
Salaries and benefits (Note 13)	115,474	107,473
Transfer agent and filing fees	9,791	31,588
Travel	-	900
	<u>136,872</u>	<u>(565,102)</u>
Net income (loss) from continuing operations	(153,757)	527,067
Net loss from discontinued operations (Note 4)	-	(1,837,849)
Net loss for the period	<u>(153,757)</u>	<u>(1,310,782)</u>
Other comprehensive loss		
Items that may be reclassified subsequently to profit or loss:		
Translation adjustment	(169,573)	(5,171,250)
Comprehensive loss for the period	<u>\$ (323,330)</u>	<u>\$ (6,482,033)</u>
Basic and diluted loss per share	\$ (0.00)	\$ (0.01)
Weighted average number of common shares outstanding	<u>88,494,821</u>	<u>87,844,821</u>

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 (DEFICIT)
UNAUDITED – PREPARED BY MANAGEMENT
(Expressed in United States Dollars)

	Capital Stock		Convertible Notes – Equity Component	Stock Options Reserve	Warrants Reserve	Translation Reserve	Deficit	Total Shareholders' Equity
	Shares	Amount						
Balance – January 31, 2016	87,844,821	\$ 47,416,203	\$ 2,814,173	\$ 1,034,242	\$ 6,099	\$ (684,574)	\$(62,880,745)	\$ 12,294,602
Cumulative translation adjustment	-	-	-	-	-	(5,171,249)	-	(5,171,249)
Net loss for the period	-	-	-	-	-	-	(1,310,782)	(1,310,782)
Balance – April 30, 2016	87,844,821	\$ 47,416,203	\$ 2,814,173	\$ 1,064,741	\$ 6,099	\$(5,855,823)	\$(64,191,527)	\$ 18,776,633
Balance – January 31, 2017	88,494,821	\$ 47,689,739	\$ 2,003,196	\$ 153,375	\$ -	\$ 265,447	\$(56,315,695)	\$ (6,203,938)
Cumulative translation adjustment	-	-	-	-	-	(169,573)	-	(169,573)
Net loss for the period	-	-	-	-	-	-	(153,757)	(153,757)
Balance – April 30, 2017	88,494,821	\$ 47,689,739	\$ 2,003,196	\$ 153,375	\$ -	\$ 95,874	\$(56,469,452)	\$ (6,527,268)

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
 For the three months ended April 30
 (Expressed in United States Dollars)

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss) from continuing operations	\$ (153,757)	\$ 527,067
Items not involving cash:		
Accretion of convertible notes	655,150	180,501
Depreciation and depletion	13,112	14,868
Equity loss in partnership	16,885	(38,035)
Unrealized gain on foreign exchange	(801,076)	(2,246,399)
Changes in non-cash working capital items:		
Accounts receivable	(29,407)	33,991
Prepays	26,319	(3,519)
Accounts payable and accrued liabilities	(29,395)	1,377,409
Operating cash flows from continuing operations	(302,169)	(154,117)
Operating cash flows from discontinued operations (Note 4)	-	(1,276,618)
Net cash used in operating activities	(302,169)	(1,430,735)
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash associated with assets held for sale (Note 4)	-	(908,374)
Exploration and evaluation expenditures	-	(9,575)
Investing cash flows from continuing operations	-	(917,949)
Investing cash flows from discontinued operations (Note 4)	-	(483,273)
Net cash used in investing activities	-	(1,401,222)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal repayment of Credit Facility	-	(1,709,820)
Net cash used in financing activities	-	(1,709,820)
Foreign exchange effect on cash	(12,360)	-
Change in cash for the period	(314,529)	(4,541,777)
Cash, beginning of the period	2,532,786	6,340,591
Cash, end of the period	\$ 2,218,257	\$ 1,798,814

Supplemental cash flow information (Note 18)

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

TERRACE ENERGY CORP.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED APRIL 30, 2017 AND 2016
(Expressed in United States Dollars)

1. NATURE OF OPERATIONS AND GOING CONCERN

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 Suite 407, 202 Travis Street, Houston, Texas 77002. The registered and records office is located at Suite 1000 – 595 Howe Street, Vancouver, British Columbia, Canada V6C 2T5.

The Company had negative cash flow from its continuing operating activities for the three months ended April 30, 2017 and has a limited history of production or profitability and its financial resources will not be sufficient to fund its debt obligations and ongoing activities beyond the near term (see Commitments described in Note 13). These conditions indicate the existence of material uncertainties that may cast significant doubt about the Company’s ability to continue as a going concern. The Company will need to raise additional capital or seek other strategic alternatives to meet its debt obligations and to carry out its future oil and gas acquisition, exploration and development activities. There are no guarantees that the Company will be able to raise such additional capital when needed.

These unaudited 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. Management believes that the going concern assumption is appropriate for these unaudited condensed consolidated interim financial statements since management continues to seek and evaluate strategic alternatives and financial options to enable the Company to meet its debt obligations and to carry out its future oil and gas acquisition, exploration and development activities. These unaudited 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. Such adjustments could be material.

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, 2017. 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, 2017. The policies applied in these condensed consolidated interim financial statements are based on IFRS issued and outstanding as of April 30, 2017.

The Board of Directors approved the unaudited condensed consolidated interim financial statements on June 20, 2017.

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.

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2. BASIS OF PRESENTATION (Continued)

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 future 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 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.

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 and discontinued operations

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 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.

Judgment is applied in determining whether disposal groups represent a component of the entity, the results of which should be recorded as discontinued operations in the consolidated statements of operations and comprehensive income (loss).

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3, SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of judgments and estimates (Continued)

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.

Going concern

The assessment of the Company's ability to continue as a going concern and to raise sufficient funds to pay its ongoing operating expenditures, meet its liabilities for the ensuing year, and to fund planned and contractual exploration programs, involves significant judgment based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

Principles of consolidation

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

During the year ended January 31, 2017, the Company's ownership in Terrace STS, LLC ("Terrace STS") was reduced from 100% down to 5% (See Note 4). As of May 20, 2016, Terrace STS was deconsolidated from the financial statements of the Company. Prior to that date, the results of operations, cash flows and financial position were consolidated within the financial statements of Terrace Energy Corp. Subsequent to May 20, 2016, Terrace STS was dissolved and the Company disposed of its 5% interest.

During the year ended January 31, 2017, the Company dissolved two of its wholly owned subsidiaries, Terrace BWP, LLC and Terrace Cutlass, LLC, as neither of these subsidiaries had any ongoing business activities.

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NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
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3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Accounting standards that will become effective in future periods

The IASB or International Financial Reporting Interpretation Committee have issued pronouncements effective for accounting periods beginning on or after February 1, 2017. Only those that may significantly impact the Company are discussed below:

IFRS 9 Financial Instruments (2014)

IFRS 9 contains accounting requirements for financial instruments and replacing IAS 39 *Financial Instruments: Recognition and Measurement*. The standard contains requirements in the following areas:

- Classification and measurement. Financial assets are classified by reference to the business model within which they are held and their contractual cash flow characteristics. The 2014 chapter of IFRS 9 introduces a “fair value through other comprehensive income” category for certain debt instruments. Financial liabilities are classified in a similar manner to under IAS 39; however, there are differences in the requirements applying to the measurement of an entity's own credit risk.
- Impairment. The 2014 chapter of IFRS 9 introduces an “expected credit loss” model for the measurement of the impairment of financial assets, so it is no longer necessary for a credit event to have occurred before a credit loss is recognized.
- Hedge accounting. Introduces a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.
- Derecognition. The requirements for the derecognition of financial assets and liabilities are carried forward from IAS 39.

Applicable to annual periods beginning on January 1, 2018. The Company has not assessed the impact of this pronouncement.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 provides a single, principles based five-step model to be applied to all contracts with customers.

The five steps in the model are as follows:

- Identify the contract with the customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contracts
- Recognize revenue when (or as) the entity satisfies a performance obligation.

Guidance is provided on topics such as the point in which revenue is recognized, accounting for variable consideration, costs of fulfilling and obtaining a contract and various related matters. New disclosures about revenue are also introduced.

Applicable to annual periods beginning on January 1, 2018. The Company has not assessed the impact of this pronouncement.

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3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

IFRS 16 Leases

IFRS 16 specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17 *Leases*.

Applicable to annual periods beginning on January 1, 2019. The Company has not assessed the impact of this pronouncement.

4. DISPOSITION OF SUBSIDIARIES AND DISCONTINUED OPERATIONS

On June 6, 2014, 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 the Company, 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 discretion of Terrace STS. During the year ended January 31, 2015, Terrace STS 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 original term of the facility was 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 was to be paid monthly; principal and PIK interest were to be paid upon maturity on May 31, 2018.

As at January 31, 2015, Terrace STS was not in compliance with the asset coverage ratio and the leverage ratio pursuant to the agreement. As a result of the non-compliance of the credit agreement requirements, the lender declared a default during February 2016 and asserted default interest of 5% per annum back to the original date of non-compliance of August 31, 2015.

During the year ended January 31, 2017, the Company entered into a letter of intent with its secured lender whereby the lender to the Terrace STS entity agreed to convert its secured debt at the date of the transaction into 95% of the membership units of Terrace STS. On May 20, 2016, the Company completed the transaction to exchange the outstanding obligation owed to the lender into membership units of Terrace STS. Following the transaction, the Company continued to own the remaining 5% and operated Terrace STS pursuant to a management contract, as well as certain incentives.

The Company eliminated debt obligations represented by a credit facility owed to the lender of \$24,964,995 (net of unamortized discount and including accrued interest of \$530,649) as a result of the debt to equity exchange transaction. Due to relinquishment of control of the subsidiary, the net assets of Terrace STS totaling \$24,922,070 were deconsolidated from the financial statements of Terrace Energy Corp. upon completion of the transaction. The fair market value of the remaining 5% ownership in Terrace STS was determined to be \$1,313,947 and recorded as long-term investment in Terrace STS within the statements of financial position. The Company recognized a gain of \$1,356,872 on the disposition of the interest in Terrace STS.

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4. DISPOSITION OF SUBSIDIARIES AND DISCONTINUED OPERATIONS (Continued)

During the year ended January 31, 2017, Terrace STS was dissolved and the Company received cash on dissolution of \$223,438 for the disposal of the remaining 5% interest held by the Company and recorded a net loss of \$1,090,509.

In January 2017, the Company also dissolved two of its subsidiaries, Terrace BWP, LLC and Terrace Cutlass, LLC, since neither of these subsidiaries had any ongoing business activities.

As the cash flows related to the operations of Terrace STS, as well as Terrace Cutlass, LLC and Terrace BWP, LLC, are distinguished, both operationally and for financial reporting purposes, from the rest of the entity, the financial performance of the two projects within these entities for the current and comparative periods have been presented separately as discontinued operations in the consolidated statements of operations and comprehensive income (loss) and cash flows.

The reported net loss from the discontinued operations is comprised of the following:

	2017	2016
Revenue		
Oil and gas sales	\$ -	\$ 299,689
Direct operating expenses	-	
Production and operating	-	565,984
Depreciation and depletion	-	-
	-	(266,295)
Other expenses		
Financing	-	1,459,205
Salaries and benefits	-	112,349
	-	1,571,554
Net loss from discontinued operations, net of tax	\$ -	\$ (1,837,849)

The reported cash flows from the discontinued operations are as follows:

	2017	2016
Net loss from discontinued operations, net of tax	\$ -	\$ (1,837,849)
Accretion of decommissioning obligations	-	2,566
Non-cash interest expense	-	558,665
Operating cash flows from discontinued operations	-	(1,276,618)
Exploration and evaluation expenditures	-	(483,273)
Investing cash flows from discontinued operations	\$ -	\$ (483,273)

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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% operated working interest (the "WI") in certain oil and gas leases covering approximately 147,000 gross mineral acres in Maverick County, Texas, USA (the "Maverick County Project") from SWEPI LP ("Shell Oil"). The acreage to be acquired includes potential reserves in the Eagle Ford Shale, Buda Limestone and several other intervals of Cretaceous age formations including the newly emerging Pearsall Shale Trend, which have been proven productive on a regional basis. The agreement allows BTLP to secure the WI through a combination of cash payments, which have been made, and drilling obligations. The material terms of the Farmout Agreement between the BTLP and Shell Oil are as follows:

1. the BTLP has made an up-front cash payment of \$13 million;
2. 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;
3. upon completion of each well drilled under this agreement, the BTLP may request an assignment of 50% of Shell Oil's interest in such well;
4. upon making the carry payment in full, the BTLP may request an assignment of 50% of Shell Oil's interest in all of the subject leases and shall have the option, but not the obligation, 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
5. 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.

In addition to the previously funded \$13 million up-front payment, as of January 31, 2017, the BTLP has spent approximately \$40 million towards its drilling obligation to Shell Oil. During the year ended January 31, 2016, the BTLP was also successful in renegotiating the schedule under which its long-term obligations under its Farmout Agreement. Under the fourth amendment to the Farmout Agreement, executed during the fourth quarter of 2015, the BTLP has deferred all further material capital expenditure obligations until calendar year 2017, at which point the BTLP will be obligated to resume expenditures of \$25 million in 2017 and the remaining balance of the Carry Payment and drilling obligation (approximately \$38 million) in 2018. The BTLP also retains the option to pay approximately \$2 million in liquidated damages at the end of 2017 if it chooses not to further defer drilling operations at that point. If the Carry Payment is not satisfied in full by the end of 2018, then the BTLP will be required to pay \$4 million in liquidated damages and the Farmout Agreement will be terminated.

During the year ended January 31, 2016, the BTLP drilled a new Eagle Ford Shale well, the Chittim #10H, which was successfully completed during July 2015. During the year ended January 31, 2017, the BTLP drilled the Chittim #4H, #11H and #12H wells. The BTLP also performed a minimal completion on one of the previously drilled Buda Limestone wells, the Chittim #4H. Prior to these activities, the Company sought and came to an agreement with BlackBrush wherein to preserve capital, the Company would not contribute its share of costs to drill and complete these additional wells. As a result, the Company's 50% ownership interest in the BTLP was reduced from 50% to approximately 44% during fiscal 2016, and to 38% during fiscal 2017. In accordance with the provisions of the BTLP agreement, the Company is not entitled to any revenue and expense allocations or distribution of revenue proceeds from the Chittim #10H, #4H, #11H and #12H wells. . The Company and its partner have reached agreement whereby the partner will continue to fund 100% of the capital obligations under this project through the fulfillment of BTLP's capital obligations under the Farmout Agreement. The Company's interest in BTLP will be periodically adjusted based on total capital contributions to BTLP. It is anticipated that the Company's interest in BTLP will remain above 20% at the completion of these capital obligations.

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5. INVESTMENT IN PARTNERSHIP (Continued)

The carrying value of \$5,088,811 (\$5,105,697 at January 31, 2017), which includes \$24,483,125 (\$24,483,125 at January 31, 2017) in advances, are capital contributions and represent 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 BTLP of \$19,394,313 (2016 - \$19,377,428). Revenues and expenses attributable to the sole risk operations conducted by BlackBrush totaling a loss of \$117,602 for the year ended January 31, 2017 (2016 - \$5,248,025) are excluded from income and allocated to the partner before allocations of income to the partners in accordance with their ownership percentages. The Company's share of the BTLP loss recognized during the three months ended April 30, 2017 was 16,885 (2016 - \$38,035).

Summary of financial information of the BTLP

<i>As at April 30,</i>	2017	2016
Assets		
Cash	\$ 238,580	\$ 181,980
Other current assets	257,680	89,475
Property and equipment	19,156,904	17,019,589
		\$ 1,791,044
Liabilities		
Current liabilities	\$ 978,359	\$ 1,074,625
Decommissioning obligations	337,548	328,855
Deferred income tax liability		-
	\$ 1,315,907	\$ 1,403,480
For the quarter ended April 30,		
	2017	2016
Revenue	\$ 486,348	\$ 104,272
Direct operating costs		
Production and operating	155,737	81,279
Depreciation and depletion	316,392	128,304
Operating income (loss)	14,219	(105,311)
Other expenses	(26,736)	(43,695)
Net loss and comprehensive loss for the period	\$ (12,517)	\$ (149,006)

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6. EXPLORATION AND EVALUATION ASSETS

	Big Wells	STS Olmos	STS South Lease	Total
Balance – January 31, 2016	-	2,354,186	1,341,112	3,695,298
Acquisition costs	-	-	9,575	9,575
Exploration and evaluation	-	83,076	-	83,076
Expenditures during the year	-	83,076	9,575	92,651
Effect of changes in foreign exchange rates	-	-	86,116	86,116
Disposition (Note 4)	-	(2,437,262)	(1,436,803)	(3,874,065)
Balance – January 31, 2017 and April 30, 2017	\$ -	\$ -	\$ -	\$ -

During the year ended January 31, 2017, due to the uncertainty regarding future oil and gas prices and the likelihood of having to commit additional capital in the near term, the Company disposed of its interest in the STS South Lease for \$1,300,000 and, as a result, recorded a loss of \$136,803 during the year. During the year ended January 31, 2017, the exploration and evaluation assets for STS Olmos were deconsolidated from the Company pursuant to the disposal of Terrace STS (Note 4).

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7. PROPERTY AND EQUIPMENT

Cost	Other Equipment	Leaseholds	Oil and Gas	Total
Balance – January 31, 2016	\$ 137,722	\$ 117,172	\$ 32,294,162	\$ 32,549,056
Effect of changes in foreign exchange rates	3,541	3,696	-	7,237
Disposition (Note 4)	-	-	(32,294,162)	(32,294,162)
Balance – January 31, 2017	\$ 141,263	\$ 120,868	\$ -	\$ 262,131
Effect of changes in foreign exchange rates		(819)	-	(819)
Balance – January 31, 2017 and April 2017	\$ 141,263	\$ 120,049	\$ -	\$ 261,312
Accumulated depreciation and depletion				
Balance – January 31, 2016	111,006	50,969	9,129,525	9,291,500
Charge for period	35,917	20,967	837,821	894,705
Disposition (Note 4)	-	-	(9,967,346)	(9,967,346)
Effect of changes in foreign exchange rates	(5,660)	(332)	-	(5,992)
Balance – January 31, 2017	\$ 141,263	\$ 71,604	\$ -	\$ 212,867
Charge for period	-	13,112	-	13,112
Effect of changes in foreign exchange rates	-	(9,147)	-	(9,147)
Balance – April 30, 2017	\$ 141,263	\$ 76,569	\$ -	\$ 216,832
Net book value				
Balance – January 31, 2017	\$ -	\$ 49,264	\$ -	\$ 49,264
Balance – April 30, 2017	\$ -	\$ 44,480	\$ -	\$ 44,480

8. CONVERTIBLE NOTES

During 2013, the Company completed two non-brokered private placements of convertible, unsecured promissory notes in the aggregate principal amount of CAD \$40,000,000. The original notes were due April 2, 2018, paid interest of 8% per annum and were convertible into 20,000,000 common shares of the Company at CAD \$2.00 per share. In October 2014, the Company obtained approval for an arrangement under the *Business Corporations Act* (British Columbia) pursuant to which all of the issued and outstanding notes were exchanged for new 8% convertible unsecured notes of the Company due April 2, 2018 and governed by a trust indenture (the “Existing Notes”). The Existing Notes contained substantially similar economic terms as the original notes, including the same interest rate, maturity date and conversion price; however, they were listed for trading on the Exchange.

In response to the current market conditions and the financial position of the Company, the quarterly interest payment due January 31, 2016 was not paid. Under the trust indenture in place at January 31, 2016, an event of default would only occur if the Company failed to make an interest payment within the 15 day cure period provided for in the indenture, in respect of two consecutive interest payment dates. As such, the Company was not in default as of January 31, 2016 for failing to make the January 31, 2016 payment. Subsequent to January 31, 2016, the Company proposed a plan of arrangement (the “Arrangement”) under the *Business Corporations Act* (British Columbia) pursuant to which all of the Existing Notes would be exchanged for new convertible secured notes of the Company (the “New Notes”) due April 2, 2021 (the “Maturity Date”), which are governed by a new trust indenture.

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7. CONVERTIBLE NOTES (Continued)

During May 2016, the Arrangement was approved and the holders of the Existing Notes received \$1,000 in principal amount of New Notes for each \$1,000 principal amount of Existing Notes held by such noteholder. Interest owing to noteholders on the Existing Notes to the date of such exchange totaling CAD \$1,619,326 was forgiven at the time of exchange. While the Existing Notes are unsecured, the New Notes are a secured obligation of the Company, guaranteed by a general security agreement against all of the Company's assets, which includes the shares of the two United States holding companies, Terrace US Holdings LLC and Terrace Investment Holdings, Inc., but not the assets of these subsidiaries. Additionally, the New Notes are interest-free, but subject to a maturity bonus equal to 5% of the aggregate total principal amount of the New Notes payable on the Maturity Date (the "Maturity Bonus"). If the New Notes are redeemed in accordance with their terms at any time within 180 days prior to the Maturity Date, one-half of the Maturity Bonus will be payable.

Carrying value of secured assets at April 30, 2017:

Cash	\$	786,990
Accounts receivable		11,744
Prepays		18,370
Property and equipment		42,091
	<u>\$</u>	<u>859,195</u>

The Maturity Bonus will be payable, at the Company's election, in cash or through the issuance of common shares of the Company at a price equal to the volume weighted average of the Company's common shares on its principal stock exchange for the ten trading days prior to any such issuance.

The Company has the right to convert all or part of the New Notes into common shares at any time if the market price of the common shares on the Exchange trades at CAD \$0.70 or higher for a period of 30 consecutive trading days. Holders of the New Notes may convert all or part of the outstanding principal amount of their convertible notes at a conversion price of CAD \$0.50 at any time during the term of the convertible notes.

Due to the substantial changes in the terms and cash flows associated with the notes following the exchange for the New Notes, IAS 39 requires that the exchange be accounted for as an extinguishment of the Existing Notes and the issuance at fair value of the New Notes. The Company estimated a discount rate of 20% in determining the fair value of the New Notes. In May 2016, a gain of \$15,264,839 was recognized by the Company related to the extinguishment of the Existing Notes.

At April 30, 2017, CAD \$38,265,000 of notes were outstanding and convertible into 76,530,000 shares (2016 - CAD \$38,590,000). The following table reconciles the carrying amount of the Existing Notes from January 31, 2016 through May 13, 2016:

	Liability	Equity	Total
Balance, January 31, 2016	25,875,415	2,814,173	28,689,588
Accretion of discount	201,814	-	201,814
Effect of changes in foreign exchange rates	(1,130,801)	-	(1,130,801)
Debt extinguishment	(24,946,428)	(2,814,173)	(27,760,601)
Balance, May 13, 2016	\$ -	\$ -	\$ -

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7. CONVERTIBLE NOTES (Continued)

The following table reconciles the carrying amount of the New Notes from May 13, 2016 through April 30, 2017:

	Liability	Equity	Total
Issuance of New Notes on May 13, 2016	\$ 11,769,496	\$ 2,029,170	\$ 13,798,666
Accretion of discount	1,807,487	-	1,807,487
Conversion of notes	(247,562)	(25,974)	(273,536)
Effect of changes in foreign exchange rates	53,198	-	53,198
Balance, January 31, 2017	\$ 13,382,619	\$ 2,003,196	\$ 15,385,815
Accretion of discount	638,557	-	638,557
Effect of changes in foreign exchange rates	(618,944)	-	(618,944)
Balance, April 30, 2017	\$ 13,402,233	\$ 2,003,196	\$ 15,405,429

8. CAPITAL STOCK

The Company has unlimited authorized common shares without par value. At April 30, 2017, the Company has 88,494,821 (January 31, 2017 - 88,494,821) shares outstanding.

Share issues

During the quarters ended April 30, 2017 and April 30, 2016, the Company did not issue any common shares.

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

As at April 30, 2017, the Company has 700,000 (January 31, 2017 – 700,000) RSUs outstanding with a grant date fair value of CAD \$2,742,208 based on the stock prices at the time of grant. 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 ten 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.

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8. CAPITAL STOCK (Continued)

Restricted share units (Continued)

The Company recognizes compensation expense for the expected number of RSUs expected to vest over the vesting period. As of April 30, 2017, there are no contemplated transactions that would give rise to vesting; therefore, no compensation expense has been recognized.

Convertible notes

As at April 30, 2017 and January 31, 2017, the Company had issued and outstanding convertible notes with a face value of CAD \$38,265,000 convertible into 76,530,000 common shares (Note 7).

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 of 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 Black-Scholes method of accounting to fair value the share-based payments arising from the grant of stock options. Under this method, the Company recorded share-based payments expense of \$nil for the quarter ended April 30, 2017 and 2016.

Outstanding stock options and warrants

Stock option transactions and the number of stock options outstanding as at April 30, 2017 are summarized as follows:

Number of Options	Number of Options Exercisable	Exercise Price (CAD)	Expiry Date	Weighted Average Remaining Contractual Life (Years)
150,000	150,000	\$ 1.35	July 8, 2017	.19

The weighted average exercise price of the outstanding stock options at April 30, 2017 is CAD \$1.35 (201 - CAD \$0.26). There have been no stock options granted during the quarter ended April 30, 2017 and the year ended January 31, 2017.

At April 30, 2017 and January 31, 2017, there were no warrants outstanding.

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9. FINANCING EXPENSES

	Three months ended April 30,	
	2017	2016
Continuing Operations:		
Interest expense	\$ -	\$ 607,189
Accretion of convertible notes	655,150	180,501
Total financing expense from continuing operations	655,150	787,690
Discontinued Operations:		
Interest expense	-	897,974
Accretion of decommissioning obligations	-	2,566
Amortization of financing costs	-	220,525
PIK interest	-	338,140
Total financing expense from discontinued operations	-	1,459,205
Total	\$ 655,155	\$ 2,246,895

10. FINANCIAL INSTRUMENTS

The Company has classified its financial instruments as follows:

- Cash and restricted cash – as FVTPL;
- Accounts receivable and operators bond – as loans and receivables; and
- Accounts payable and accrued liabilities, 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 and accounts payable and accrued liabilities approximate their fair values due to the short-term maturity of these financial instruments. The fair value of the operator's 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.

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10. FINANCIAL INSTRUMENTS (Continued)

(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 was exposed to interest rate risk on its credit facility whereby interest was based on LIBOR and its convertible notes, which had a fixed interest rate. During fiscal 2017, the Credit Facility was settled and the convertible notes were exchanged to interest-free notes, accordingly, the Company is no longer exposed to significant interest rate risk.

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

The assets and liabilities with exposure to foreign currency risk are those that are denominated in a different currency than the currency determined to be the functional currency of the respective entity as of the end of the period. The following assets and liabilities represent the Company's exposure to foreign currency risk:

	April 30, 2017 (USD)	January 31, 2017 (USD)
Cash	\$ 2,204,821	\$ 2,485,985
Accounts receivable	39,677	10,650
Operator's bond	25,000	25,000
Accounts payable and accrued liabilities	(494,615)	(526,810)
Net	\$ 1,774,883	\$ 1,994,825

Based on the above net exposure as at, a 5% change in the Canadian/US exchange rate would impact the Company's net loss and comprehensive loss by approximately \$88,744 (January 31, 2017 - \$99,741).

(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. During the year ended January 31, 2017, the amounts outstanding under the Credit Facility were settled with member units of Terrace STS, and accordingly, as of the date of this report there are no amounts due under the Credit Facility. The Credit Facility has been terminated and the assets and liabilities of Terrace STS are no longer attributable to the Company following the transaction. In addition, the Company reached an agreement with its noteholders and the notes outstanding at January 31, 2016 have been exchanged for new notes in the face amount of

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10. FINANCIAL INSTRUMENTS (Continued)

CAD \$38,590,000 that do not pay interest and are due April 2, 2021. The \$1,240,293 of accrued interest related to the notes at May 13, 2016 was forgiven at the time of the transaction.

As at April 30, 2017, the Company had cash of \$2,218,257, accounts receivable of \$51,421, and current liabilities of \$622,928. Current liabilities of \$122,928 are due within three months of April 30, 2017. The remaining \$500,000 balance relates to a contingent liability recorded for provision of the asserted liquidated damages (see Note 12).

The Company through its investment in BTLP, owns varying interests in oil and gas properties subject to joint operating agreements and other 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 has working capital and available resources combined with future cash flow from operations which will not be sufficient to fund its share of the agreed-upon estimated costs of proposed future development activities. As a consequence, the Company will have to secure new sources of capital, which is not assured, to maintain its interests in such proposed development and there is no assurance such capital could be obtained.

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 April 30, 2017.

	Level 1	Level 2	Level 3
Cash	\$ 2,218,257	\$ -	\$ -
Convertible notes	(2,475,971)	-	-
	<u>\$ (257,714)</u>	<u>\$ -</u>	<u>\$ -</u>

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, 2017.

	Level 1	Level 2	Level 3
Cash	\$ 2,532,786	\$ -	\$ -
Convertible notes	(2,940,747)	-	-
	<u>\$ (407,961)</u>	<u>\$ -</u>	<u>\$ -</u>

11. CAPITAL DISCLOSURES

The Company considers its capital under management to be shareholders' equity, convertible notes and the 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, 2017. As at April 30, 2017, the Company is not subject to any externally imposed capital requirements.

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12. COMMITMENTS AND CONTINGENCIES

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 \$72,511 in years three, four and five, and CAD \$76,198 in years six and seven. In December 2015, the Company entered into a sublease of the office space commencing February 1, 2016 through the remaining term of the lease for CAD \$58,992 per year.

The Company has a commitment to make monthly rental payments pursuant to an office rental agreement in Houston, Texas, through October 31, 2017. The lease requires total payments of \$30,336 for the final six months on the lease.

Total rent expense net of sublease payments included in the consolidated statements of operations and comprehensive income (loss) for the three months ended April 30, 2017 amounted to \$17,718 (2016 - \$46,196).

At April 30, 2017 the Company has convertible notes outstanding in the face amount of CAD \$38,265,000 that do not pay interest and are due April 2, 2021 (Note 9).

During April 2015, the Company entered into an agreement, 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 this agreement, the Company was 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 severe drop in commodity prices, the Company declared the agreement to be in a state of *force majeure* in accordance with the applicable terms of the agreement, effectively placing its obligations on hold until market conditions improve sufficiently to allow for economic development of the acreage. The farmor disputed this declaration and filed suit to enforce the liquidated damages clause of the agreement. In June 2016 the court upheld the farmor's motion for summary judgment against the wholly owned subsidiary. Accordingly the Company has recorded a provision in the amount of the asserted liquidated damages of \$500,000. The Company will continue to vigorously defend its position. The Company believes this suit to be without merit and has appealed the court ruling including a counter-claim against the farmor for damages relating to breach of contract. A hearing on the appeal is not expected until mid-2017.

13. 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:

	Three months ended April 30,	
	2017	2016
Short-term compensation	\$ 186,553	\$ 242,531
Recoveries from consulting and management services revenue	(87,904)	(91,052)
	\$ 98,949	\$ 151,479

During the year ended January 31, 2017, management and staff voluntarily modified their employment contracts to reduce salaries and eliminate key long-term employment benefits. The Company established a third party consulting practice to cover salaries for technical personnel. At April 30, 2017, these changes resulted in recoveries of \$87,904.

Included in accounts payable and accrued liabilities as at April 30, 2017 are amounts payable to key management personnel totalling \$17,585 (January 31, 2017 - \$8,374).

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13. RELATED PARTY TRANSACTIONS (Continued)

At April 30, 2017, convertible notes held by key management personnel and their close family members totalled CAD \$3,230,000 (January 31, 2017 - CAD \$3,230,000). No interest was paid on these convertible notes in 2017 and 2016.

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

14. SEGMENTED INFORMATION

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

	April 30, 2017		
	USA	Canada	Total
Property and equipment	-	44,480	44,480
Investment in partnership	5,088,811	-	5,088,811
	\$ 5,088,811	\$ 44,480	\$ 5,133,291

	January 31, 2017		
	USA	Canada	Total
Property and equipment	9,879	39,385	49,264
Investment in partnership	5,105,697	-	5,105,697
	\$ 5,115,576	\$ 39,385	\$ 5,154,697

15. SUPPLEMENTAL CASH FLOW INFORMATION

During the quarter ended April 30, 2016, the Company:

- a) had accounts payable and accrued liabilities of \$400,197 related to exploration and evaluation expenditures;