TERRACE ENERGY CORP.
(the “Company”, “Corporation” or “Terrace”)
MANAGEMENT’S DISCUSSION AND ANALYSIS
OF THE COMPANY’S FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JULY 31, 2017 AND 2016

As of September 29, 2017

Introduction

The following management discussion and analysis of the financial condition and results of operations (“MD&A”) of the Company has been prepared by management, in accordance with the requirements of National Instrument 51-102 as of June 20, 2017 and should be read in conjunction with the Condensed Consolidated Interim Financial Statements for the six months ended July 31, 2017 and 2016 and the related notes contained therein, which have been prepared under International Financial Reporting Standards (“IFRS”). The information contained herein is not a substitute for detailed investigation or analysis on any particular issue and is not intended to be a comprehensive review of all matters and developments concerning the Company. Additional information relevant to the Company’s activities including the appraisal report on proved and probable reserves can be found on SEDAR at www.sedar.com and the Company’s website at www.terraceenergy.net.

All financial information in this report has been prepared in accordance with IFRS and all monetary amounts referred to herein, are in United States dollars, unless otherwise stated.

Caution Regarding Use of Barrels of Oil Equivalent (BOEs)

BOEs/boes may be misleading, particularly if used in isolation. A BOE conversion ratio of six (6) Mcf to one (1) bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. As the value ratio between natural gas and crude oil based on the current prices of natural gas and crude oil is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

Cautionary Statement Regarding Forward Looking Statements

This discussion and analysis contains "forward-looking information" and "forward-looking statements" within the meaning of applicable Canadian securities laws and the United States Private Securities Litigation Reform Act of 1995, respectively (together, "forward-looking information"), concerning the Corporation's plans for its projects, production, capital, operating and cash flow estimates, anticipated financial performance, business prospects and strategies and other general matters. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those included in the forward-looking information. The use of words such as "intend", "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe" and similar expressions are intended to identify forward-looking information. Such statements are included, among other places, in this discussion and analysis under the headings "*Executive Overview of Operations*", "*Outlook*", "*Exploration and Development Assets*", “*Financial Condition, Liquidity and Capital Resources*” and "*Risk Factors*". Statements relating to "reserves" are also forward-looking information, as they involve the implied assessment, based on certain estimates and assumptions, including that the reserves described can be profitably produced in the future. These statements and information are only predictions based on current information and knowledge. Actual future events or results may differ materially. In addition, this discussion and analysis may contain forward-looking information attributed to third party industry sources. Undue reliance should not be placed on such forward-looking information, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By its nature, forward-looking information involves numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking information will not be realized. In addition, the exploration and development of oil and gas properties involves certain significant risks,

not within the control of management, which can adversely impact the Company's plans and expectations (see "Risk Factors").

In particular, this discussion and analysis contains forward-looking information pertaining to the following:

- expectations regarding the Corporation and/or its co-venturers' ability to satisfy capital expenditure requirements to maintain the Corporation's projects in good standing;
- plans for selling project interests and/or sharing expenditure requirements with new joint venture partners;
- performance characteristics of the Corporation's producing properties;
- crude natural gas, natural gas liquids and oil production estimates and targets;
- the size of the Corporation's natural gas, natural gas liquids and oil reserves;
- planned capital expenditure programs and estimates;
- timing of commencement of fracture stimulations and drilling of additional wells and the Corporation's expectations as to the outcomes of the foregoing;
- hypotheses regarding the geology of the basins in which the Corporation has operations and is conducting exploratory work;
- expectations regarding the potential number of additional drilling locations on the Corporation's projects;
- projections of market prices and costs;
- expectations regarding future supply and demand for oil and natural gas;
- expectations regarding the ability to attract and retain appropriately qualified employees and consultants;
- expectations regarding the ability to raise capital and to add to reserves through acquisitions and development; and
- anticipated treatment under governmental regulatory regimes and tax laws.

This forward-looking information is based on a number of assumptions, including, but not limited to, the following:

- assumptions set out herein and in the Corporation's most recently filed Form 51-101F1 oil and gas report;
- stability in the credit markets and continued willingness of lenders to lend capital to issuers such as the Corporation;
- continuing availability of funds for capital expenditures through internally generated cash and/or equity raises or debt raises;
- that the Corporation will continue to satisfy its covenants and meet its obligations under the terms of its outstanding debt;
- stability of the political and fiscal regimes in the countries in which the Corporation has operations;
- ability of the Corporation to hold the mineral leases and projects in which it has interests and to find suitable industry partners to assume or share capital expenditure requirements necessary to keep various of the Corporation's projects in good standing, if and as needed;
- stable future costs;
- availability of equipment and personnel when required for operations;
- future strong demand for oil and natural gas;
- that the Corporation will not experience unforeseen delays, unexpected geological, environmental or other natural occurrences, equipment failures, permitting delays or delays in procurement of required equipment or personnel;
- that the Corporation will not experience labour or contract disputes;
- that the Corporation's financial condition and development plans and those of its co-venturers will not substantially change;
- the assumptions underlying estimates of reserves;
- that indications of early results are reasonably accurate predictors of the prospectiveness of the hydrocarbon bearing strata;
- that environmental and other regulations affecting the Corporation will not substantially change, and that required regulatory approvals will be available when required;

- that expected production from future wells can be achieved as modeled and that declines will match the modeling;
- that rates of return as modeled can be achieved;
- that reserve recoveries are consistent with management's expectations;
- that additional wells are actually drilled and completed;
- expectations and assumptions regarding future growth, results of operations, production, future capital and other expenditures (including the amount, nature and sources of funding thereof);
- plans for and results of drilling activity; and
- assumptions regarding business prospects and opportunities.

Actual results could differ materially from those anticipated in forward-looking information as a result of the risks and uncertainties set forth below and elsewhere in this discussion and analysis:

- the risk that the Corporation is unable to access required capital or conclude agreements with new industry partners to fund or assist in funding capital expenditure requirements to maintain projects in good standing and to discharge outstanding debt as it becomes due;
- continued volatility in, and depressed market prices for, oil and natural gas;
- risks inherent in oil and gas operations;
- uncertainties associated with estimating oil and natural gas reserves;
- competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel;
- incorrect assessments of the value of acquisitions;
- geological, technical, drilling and processing problems;
- uncertainties associated with the utilization of hydraulic fracturing in relation to the Corporation's existing and/or future properties;
- fluctuations in foreign exchange or interest rates and stock market volatility;
- rising costs of labour and equipment;
- inherent uncertainties involved in the legal dispute resolution process;
- changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry;
- tightening of the credit markets, global economic uncertainty, and counterparty risk;
- equipment failures, permitting delays, delays in procurement of required equipment or personnel, and labour or contract disputes;
- changes in the Corporation's financial condition and development plans or those of its co-venturers;
- risks relating to disagreements or disputes with joint venture partners, including any failure of a joint venture partner to fund its obligations;
- risks and uncertainties associated with securing necessary regulatory approvals, including the risk that the Corporation or its subsidiaries is not able for any reason to obtain and provide the information necessary to secure required approvals or that required regulatory approvals are otherwise not available when required;
- risks and uncertainties associated with potential changes in environmental or other regulations, permitting processes or taxation;
- the risk that the Corporation will be unable to successfully renegotiate the terms of contracts as may be necessary in order for the Corporation to maintain its interest in its projects;
- the risk that unexpected geological results are encountered, completion techniques require further optimization or production rates do not match the Corporation's assumptions; and
- other factors discussed under "*Risk Factors*" below.

Although the Corporation has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking information, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking information will prove to be accurate, as actual results and future events could differ materially

from those anticipated in such information. The reader is cautioned not to place undue reliance on forward-looking information. The forward-looking information contained herein is presented for the purpose of assisting investors in understanding the Corporation's expected financial and operating performance and the Corporation's plans and objectives in making an investment decision and may not be appropriate for other purposes. All forward-looking information is expressly qualified in its entirety by this cautionary statement. The Corporation disclaims any obligation to update forward-looking information to reflect events or circumstances after the date of such statements, or to reflect the occurrence of anticipated or unanticipated events, except as required by law.

Cautionary Note to United States Investors

This discussion and analysis and the Company's consolidated financial statements are prepared and presented in accordance with the rules and regulations that govern Canadian reporting issuers, as required by the TSX Venture Exchange (the "Exchange") and applicable securities laws in Canada. The Company does not report to the United States Securities and Exchange Commission, and, in its public disclosure, it may use terms which are not permitted terminology in the United States. In addition, United States investors are cautioned that the Company's consolidated financial statements do not conform with, nor are they reconciled to, accounting principles generally accepted in the United States.

Company Overview

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 and developing onshore oil and gas properties in the United States. The Company has a limited history of revenues and operating cash flows. The continuing operations of the Company are therefore dependent upon its future profitable operations and its ability to raise additional capital as required, neither of which is assured. The Company's head office is located at Suite 407, 202 Travis Street, Houston, Texas 77002 where all its operating activities are managed. It's registered and records office is located at 10th Floor, 595 Howe Street, Vancouver, British Columbia V6C 2T5. The Company also maintains its principal office at Suite 407, 202 Travis Street, Houston, Texas 77002 where all its operating activities are managed.

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

Name of subsidiary	Place of Incorporation	Percentage ownership
Terrace US Holdings LLC	USA	100%
Terrace Operating, LLC	USA	100%
TEC Operating, LLC	USA	100%
Terrace Investment Holdings Inc.	USA	100%
TEC Olmos, LLC	USA	100%

See "Exploration and Evaluation Assets" for the Company' interest in BlackBrush Terrace LP.

Executive Overview of Operations

Depressed oil and gas prices still represent a significant challenge to the industry. The long-term outlook shows some stability at current levels, but no significant indications of strengthening in the foreseeable future. Consequently, the Company has shifted its focus from capital intensive unconventional exploration projects to an objective of identifying and acquiring underdeveloped or non-core producing assets. As previously reported, the Company divested its McMullen and LaSalle County unconventional assets and is continuing its program to reduce operating costs including securing third party management and consulting contracts while the process of identifying and negotiating producing asset acquisitions is ongoing. The Company will continue its partnership in its Maverick County exploration program under arrangements which allow for continuing participation without requiring additional capital expenditures on this project.

As previously reported, The Company and its partner were successful in renegotiating the schedule under which the BlackBrush Terrace LP ("BTLP") was to commit development capital under its farmout agreement with Shell. Under the Fourth Amendment to the Farmout Agreement, negotiated during the third quarter of 2015, BTLP deferred its obligation to make any further material capital expenditure obligations until late calendar year 2017, however, due to low service and equipment prices, BTLP deemed it prudent to drill, in late 2016, two confirmation wells into the Eagle Ford Shale in the vicinity of the Chittim Heirs #10H. The Company's partner paid all of the costs associated with these two wells (the "Chittim Heirs #11H and #12H" wells) and, as a consequence, the Company's partnership interest in the BTLP was reduced by approximately 6% to 38%. 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.

During the quarter ending July 31, 2017, BTLP initiated drilling of two new Eagle Ford Shale wells, the Chittim Heirs #16H and the Chittim Heirs #17H. Both wells have been successfully drilled and completed. Flow back and testing operations are currently in progress. Early results are encouraging. We expect these wells will provide confirmation of the long-term viability of this project. As agreed, the Company's partner will contribute 100% of the capital costs of these wells. The capital accounts of the BTLP partnership will be adjusted to reflect these expenditures. Through July 31, 2017, the Company's interest in BTLP stands at 32.21%.

As part of its ongoing program to reduce or eliminate corporate costs while pursuing new business ventures, management and staff voluntarily modified their employment contracts to reduce salaries and eliminate key long-term employment benefits. The Company has established an active third-party consulting practice intending to cover salaries for technical personnel. Income from this practice is currently contributing approximately 40% of total employee expenses.

As previously reported, the Company entered into a Plan of Arrangement wherein it exchanged previously issued 8% unsecured notes that would have matured in April 2018 (the "Old Notes") for new notes maturing in April 2021, which are not interest bearing (the "New Notes"). The Old Notes, having a face value of $38,590,000 CAD, were exchanged for an equivalent face value of. The unpaid interest outstanding at the time of the exchange was forgiven when the exchange was completed. This note exchange was critical to the Company's overall strategy of preserving liquidity so it can pursue a new strategic direction.

Outlook

The time frame in which oil prices will sufficiently recover to warrant large scale exploration, remains unclear. As a result, Management took steps to reduce costs, generate cash and eliminate obligations associated with maintaining its interest in the Maverick County Projects successful ongoing delineation drilling program through its arrangements with its partner to ensure on-going capital development funding without further capital

contributions from the Company. Under these arrangements, BTLP has successfully drilled and completed five key delineation wells to date.

Looking forward, the Company has shifted its strategic focus from the acquisition and development of grass-roots exploration projects to large scale project management, whereby the Company would partner with third-party private equity providers to opportunistically acquire, reorganize, if necessary, and develop distressed assets or assets that are no longer core to other oil & gas companies. To that end, the Company is currently having discussions regarding such opportunities with a number of interested parties. There are, however, no assurances the Company will successfully conclude a transaction in the near-term or at all.

Exploration and Development Assets

The following is a brief description of the principal assets owned by the Company during the quarter:

Maverick County Project (Investment in BlackBrush Terrace LP)

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 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;

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.

During 2013, the BTLP successfully tested the Eagle Ford formation through the re-entry and completion of the SWEPI Chittim #F-1H, which was previously drilled and shut in by Shell Oil in 2011 and drilled and completed a second well to test the Eagle Ford and Buda Limestone Formations. To date, these wells have produced in excess of 50,000 BOE (gross) from the Eagle Ford Shale and are continuing to produce. The BTLP also drilled and evaluated an obligatory Pearsall Shale evaluation well, the Chittim #1H which showed numerous positive indications of hydrocarbons, but was not able to be completed as a commercial success.

During 2014, BTLP drilled four evaluation wells including two horizontal wells to evaluate the Buda Limestone potential on the southern portion of the ranch and two vertical stratigraphic tests to evaluate several formations from Austin Chalk through Georgetown in a portion of the ranch penetrated by a large serpentine plug (volcanic feature). Most notably, these wells confirm the presence of the Eagle Ford Shale in three separate areas of the project covering at least 50,000 gross acres.

During 2015, the BTLP drilled a new Eagle Ford Shale well, the Chittim #10H, which was successfully completed during July 2015. The well was subsequently been placed into permanent production facilities. As of July 31, 2017, the well has produced approximately 78,000 BOE (gross). In addition, BTLP drilled the Chittim #4H to evaluate the production potential of the Buda Limestone in that area of the ranch. Prior to these activities, the Company sought and came to an agreement with its partner wherein, 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 partnership was reduced to approximately 44%. In accordance with the provisions of the partnership agreement, the Company will not be entitled to any revenue and expense allocations or distribution of revenues from the Chittim #10H well.

Also during 2015, BTLP was successful in renegotiating the schedule under which its long-term obligations under its farmout agreement are due. Under the Fourth Amendment to the Farmout Agreement, executed during the fourth quarter of 2015, the BTLP has the right to defer all further material capital expenditure obligations until calendar year 2017, at which point, the BTLP is 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. BTLP also retains the option to pay approximately $2 million in liquidated damages at the end of 2017 if it chooses to further defer drilling operations at that point. If the Carry Payment is not satisfied in full by the end of 2018, then the partnership will be required to pay $4 million in liquidated damages and the Farmout Agreement will be terminated.

BTLP determined it was in its best interest to take advantage of historically low service and equipment prices and drill two confirmation wells (the Chittim Heirs #11H and #12H) into the Eagle Ford Shale in follow up to the successful completion of the Chittim Heirs #10H. The Company and its partner have agreed that the partner will provide the capital for these wells in return for additional dilution of the Company's partnership interest in an arrangement similar to that previously described for the Chittim Heirs #10H project. The Company's interest in BTLP was reduces from 44% to approximately 38% as a result of these projects. These wells were successfully drilled and completed at the end of the third quarter. The wells are currently performing in close agreement with our type curve expectations and the performance of the #10H. As of July 31, 2017, these wells have produced approximately 70,000 BOE (gross).

The Company and its partner have also agreed that the partner will provide all necessary capital to execute the planned 2017 work program in satisfaction of BTLP's obligations under the Farmout Agreement. The Company expects to maintain its partnership interest at or above 20%.

During the quarter ending July 31, 2017, BTLP initiated drilling of two new Eagle Ford Shale wells, the Chittim Heirs #16H and the Chittim Heirs #17H. Both wells have been successfully drilled and completed. Flow back and testing operations are currently in progress. As agreed, the Company's partner will contribute 100% of the capital costs of these wells. The capital accounts of the BTLP partnership will be adjusted to reflect these expenditures. Through July 31, 2017, the Company's interest in BTLP stands at 32.21%.

During the six months ended July 31, 2017, the Company's recognized share of the BTLP's net loss was $48,198. The Company has a carrying value in the partnership of $5,057,499 ($5,105,697 at January 31, 2017), which includes $24,483,125 in advances representing 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 losses of

the partnership of $19,425,626 of which approximately $17,994,062 of the loss was attributable to the impairment charge relating to two Eagle Ford evaluations wells drilled in prior years.

Results of Operations

For the six months ended July 31, 2017 and 2016

Net loss for the six months ended July 31, 2017 was $1,046,894, compared to net loss of $13,222,163 for the six months ended July 31, 2016. The results are summarized as follows:

	2017	2016
Continuing operations:		
Equity loss in partnership	$ (48,198)	$ (68,388)
Expenses		
General and administrative expenses	257,569	609,274
Consulting	(189,819)	-
Depreciation	26,290	28,275
Financing costs	1,372,023	1,350,031
Foreign exchange (gain) loss	(863,477)	(2,286,150)
Gain on note extinguishment	-	(15,126,653
Provision for contract litigation	-	500,000
Salaries and benefits	396,110	-
	(1,046,894)	14,925,223
Net income (loss) from continuing operations	(1,046,894)	(14,856,835))
Discontinued operations:		
Oil and gas revenues (net of royalties)	-	409,560
Expenses		
Production and operating	-	581,526
Other expenses		
Financing	-	1,869,408
Salaries and benefits	-	112,349
Total expenses	-	2,563,283
Net loss from discontinued operations, net of tax	-	(1,634,672)
Gain disposition of STS	-	519,051
Net income (loss) for the period	$ (1,046,894)	$ (13,222,163)

Continuing operations

Equity loss in partnership represents the Company's pro-rata share of loss of the BlackBrush Terrace LP. For the six months ended July 31, 2017 the Company's share of the partnership loss was $48,198 compared to the Company's share of the partnership net loss of $68,388 for the six months ended July 31, 2016.

General and administrative expenses for the six months ended July 31, 2017 were $163,733 compared to $207,133 for the six months ended July 31, 2016. These expenses are comprised primarily of office costs, including rent, professional fees for legal and transfer agent and Exchange fees

Financing costs for the six months ended July 31, 2017 related to continuing operations were $1,372,023 compared to $3,219,439 for the six months ended July 31, 2016. In the current period the amounts represent the accretion of the valuation discount on the convertible notes. In the prior period accretion of the valuation discount was $708,348 and interest expense on the convertible notes was $641,683. The balance of financing expense in the prior period were associated with the discontinued operations.

Provision for contract litigation for the six months ended July 31, 2017 was $Nil. The provision in 2016 was related to a contract dispute which the Company entered into to earn acreage 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 judgement 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 defending its position. The Company has appealed the court ruling including a counter-claim against the farmor for damages relating to breach of contract. The Company has filed affidavits with the courts as to the financial condition of the subsidiary which blocks any further attempts at collection on the judgement. The appeal and counter-claim is still pending in the court system.

Foreign exchange (gain) loss for the six months ended July 31, 2017 was a gain of $863,477 compared to a gain of $2,286,150 for the six months ended July 31, 2016. The change in foreign exchange was due to fluctuations in the USD exchange rate during the period and the disposition of US subsidiaries.

Gain on note extinguishment in the amount of $15,126,653 was recognized by the Company during the period ended July 31, 2016 related to the exchange of its previous 8% unsecured notes maturing in April 2018 ("Old Notes") for new notes maturing in April 2021 which are non-interest bearing ("New Notes"). The Old Notes, representing $38,590,000 CAD, were exchanged for an equivalent number of New Notes representing the same value. Due to the substantial changes in the terms and cash flows associated with the notes following the exchange for the New Notes, IAS 39 "Financial Instruments: Recognition and Measurement" requires that the exchange be accounted for as an extinguishment of the Old Notes and the issuance at fair value of the New Notes. The Company assumed a discount rate of 20% in determining the fair value of the New Notes. The gain was recognized on the extinguishment of the Old Notes.

Salaries and benefits for the six months ended July 31, 2017 were $ 396,110 compared to $172,643 after offsetting consulting income of $334,295 for the six months ended July 31, 2016. Consulting income was $189,819 in the current period.

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Discontinued operations

There were no discontinued operations in the six months ended July 31, 2017 compared to discontinued operations $1,634,672 in 2016.

For the three months ended July 31, 2017 and 2016

Net loss for the three months ended July 31, 2017 was $861,824 compared to net income of $14,532,945 for the three months ended July 31, 2016. The results are summarized as follows:

	2017	2016
Continuing operations:		
Equity loss in partnership	$ (31,313)	$ (30,353)
Expenses		
General and administrative expenses	133,913	278,990
Consulting	(99,442)	
Depreciation	13,178	13,407
Financing costs	716,873	562,341
Gain on note extinguishment	-	(15,126,653)
Foreign exchange gain	(92,957)	(88,206)
Salaries and benefits	190,259	-
	861,824	(14,360,121)
Net income (loss) from continuing operations	(893,137)	14,329,768
Discontinued operations:		
Oil and gas revenues (net of royalties)	-	109,871
Expenses		
Direct operating expenses		
Production and operating	-	15,542
Other expenses		
Financing	-	410,203
Total expenses	-	425,745
Gain on disposition of Terrace STS	-	519,051
Net income (loss) from discontinued operations, net of tax	-	203,177
Net income (loss) for the period	$ (893,137)	$ 14,532,945

Continuing operations

Equity loss in partnership represents the Company's pro-rata share of income or loss of the BlackBrush Terrace LP. For the quarter ended July 31, 2016 the Company's share of the partnership loss was $31,313 compared to the Company's share of the partnership net loss of $30,353 for the quarter ended July 31, 2016.
General and administrative expenses for the three months ended July 31, 2017 were $133,913 compared to $278,990 for the three months ended July 31, 2016. These expenses are comprised primarily of office costs, including rent, professional fees for legal and audit services, transfer agent and Exchange fees and investor relations activities.

Financing costs for the three months ended July 31, 2017 related to continuing operations were $716,873 compared to $562,341 for the three months ended July 31, 2016 and represents the cash interest on the convertible notes as well as the accretion of discount. During May 2016, the notes were restructured and the obligation to pay quarterly interest was eliminated.

Gain on note extinguishment in the amount of $15,126,653 was recognized by the Company during the period ended July 31, 2016 related to the exchange of its previous 8% unsecured notes maturing in April 2018 ("Old Notes") for new notes maturing in April 2021 which are non-interest bearing ("New Notes"). The Old Notes, representing $38,590,000 CAD, were exchanged for an equivalent number of New Notes representing the same value. Due to the substantial changes in the terms and cash flows associated with the notes following the exchange for the New Notes, IAS 39 "Financial Instruments: Recognition and Measurement" requires that the exchange be accounted for as an extinguishment of the Old Notes and the issuance at fair value of the New Notes. The Company assumed a discount rate of 20% in determining the fair value of the New Notes. The gain was recognized on the extinguishment of the Old Notes.

Foreign exchange gain for the three months ended July 31, 2017 was a gain of $92,957 compared to a gain of $88,206 for the three months ended July 31, 2016. The change in foreign exchange was due to fluctuations in the USD exchange rate during the period.

Discontinued operations

As the cash flows related to the operations of Terrace STS, LLC which was disposed of during May 2016 as well as Terrace Cutlass LLC, which was disposed of during December 2015, are clearly 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 comparative period have been presented separately as discontinued operations in this results of operations discussion and in the consolidated statements of operations and comprehensive income (loss) and statement of cash flows.

There were no discontinued operations in the six months ended July 31, 2017 compared to discontinued operations $203,177 in 2016.

Summary of Quarterly Results

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

	July 31 2017	April 30, 2017	January 31, 2017	October 31, 2016
Revenue (net of royalties)[1]	$ -	$ -	$ -	$ -
Net income (loss)	(893,137)	(153,757)[1]	(7,656,050)[2]	(2,118,044)[3]
Property and equipment	39,598	44,480	49,264	53,690
Assets held for sale[15]	-	-	-	1,520,000
Investment in partnership[13]	5,057,499	5,088,811	5,105,697	7,440,112
Total assets	7,149,334	7,518,618	7,831,004	10,353,738
Income (loss) per share – basic and diluted	(0.01)	(0.00)	(0.02)	(0.02)

	July 31, 2016	April 30, 2016	January 31, 2016	October 31, 2015
Revenue (net of royalties)[1]	$ -	$ 299,689	$ 464,771	$ 877,779
Net income (loss)	14,532,945[4]	(1,310,782)[5]	(6,634,041)[6]	(10,634,329)[7]
Exploration and evaluation[11]	1,438,695	1,496,941	3,695,298	5,676,323
Property and equipment[11]	71,265	87,990	9,719,005	21,232,741
Assets held for sale[15]	-	26,741,217	-	44,642
Investment in partnership[13]	7,423,134	7,453,487	7,471,522	10,941,479
Investment in Terrace STS[15]	1,313,947	-	-	-
Total assets	11,796,649	37,693,493	27,602,876	46,691,721
Loss per share – basic and diluted	0.17	(0.01)	(0.07)	(0.12)

Notes:

1) Net income during this period includes a non-cash deduction of $13,112 for depreciation and depletion as well as $770,520 for foreign exchange gain.
2) Revenue is primarily a result of oil and gas sales less royalties which varies each period depending on the number of wells in production. The revenues are attributable to the Terrace STS assets as well as the Terrace Cutlass assets all of which are reflected in net income (loss) from discontinued operations in the Consolidated Financial Statements for the six and three months ended July 31, 2016 and 2016 and disposed of as of July 31, 2016.
3) Net income during this period includes a non-cash deduction of $11,930 for depreciation and depletion as well as $761,292 for foreign exchange gain, and an impairment of $117,309 on the disposition of STS Olmos.
4) Net income during this period includes a non-cash deduction of $16,679 for depreciation and depletion as well as $19,045 for foreign exchange loss, a $198,021 gain on note extinguishment, impairment of $117,309 on the disposition of STS Olmos Leases and an impairment of $1,093,947 on the disposition of the 5% interest of STS.
5) Net income during this period includes a non-cash deduction of $13,407 for depreciation and depletion as well as $88,206 for foreign exchange gain, a $15,126,653 gain on note extinguishment and a $519,051 gain on disposition of Terrace STS.
6) Net loss during this period includes non-cash deductions of $14,868 for depreciation and depletion and a $2,197,944 foreign exchange gain.
7) Net loss during this period includes non-cash deductions of $41,870 for depreciation and depletion, $7,814 for impairments $(9,796) for loss on disposal of assets held for sale and $ 1,129,264 for foreign exchange gain.

8) Net loss during this period includes non-cash deductions of $1,124,867 for depreciation and depletion, $2,030 for impairments, $1,718,203 for loss on disposal of assets held for sale and $ 2,429,669 for foreign exchange gain.
9) Net loss during this period includes non-cash deductions of $1,924,390 for depreciation and depletion, $2,655,593 for impairments and $ 719,962 for foreign exchange gain.
10) Net loss during this period includes non-cash deductions of $3,072 for share–based payments, $1,748,331 for depreciation and depletion, $375,516 for impairments and $ 1,460,659 for foreign exchange loss.
11) Net loss during this period includes non-cash deductions of $7,596 for share–based payments, $833,660 for depreciation and depletion, $12,777,376 for impairments and $456,422 for foreign exchange loss.
12) Net loss during this period includes non-cash deductions of $29,180 for share–based payments, $1,847,423 for depreciation and depletion, $2,100,760 for impairments and $702,667 for foreign exchange gain.
13) The fluctuations between Exploration and Evaluation and Property and Equipment are due to the transfers of the Company's share of the costs to drill, evaluate and case the wells related to the STS Olmos project and the Cutlass project.
14) The Company entered into an agreement with BlackBrush Oil and Gas, LP. The carrying value represents the Company's share of costs to organize, acquire and fund certain agreed upon exploration and evaluation activities to-date plus the Company's share of the changes in net assets of the partnership.
15) During May 2016, the Company exchanged the debt outstanding in the 100% owned Terrace STS entity for 95% membership interests issued to the lender. At that time the Companies interest in the subsidiary was reduced to 5% and the entity was deconsolidated from the financial statements of the company. The investment in Terrace STS represents the fair market value of the retained 5% interest which has been classified as an asset available-for-sale by the Company.

Fluctuations in reported earnings during the prior quarters are primarily due to changes in oil and gas production, depletion and revenues, asset impairment charges, share-based payments, foreign exchange adjustments, asset divestitures and professional fees. The time during which the Company acquires, develops, disposes or abandons projects materially impacts the results of operations from fiscal quarter to quarter.

Financial Condition, Liquidity and Capital Resources

As at July 31, 2017, the Company had working capital of $1,495,584 (January 31, 2017 – 1,987,720, which was comprised of cash of $1,868,170 accounts receivable of $87,411 and prepaid expense of $71,656, offset by accounts payable of $531,653.

As at July 31, 2017 and the date of this report, the Company had outstanding long term convertible notes in the principal amount of CAD $38,265,000 (January 31, 2017 – CAD $38,265,000). On May 13, 2016, the Company completed an exchange of the previously outstanding notes which required quarterly interest payments calculated at 8% per annum and were due April 2, 2018 with new non-interest bearing notes, which are secured by the assets of the Terrace Energy Corp. with an extended maturity date of April 2, 2021. As part of the exchange, the outstanding, unpaid interest owed to the noteholders was forgiven. A more detailed description of the notes exchange transaction is set out in Note 9 to the Company's Consolidated Financial Statements for the year ended January 31, 2017.

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 judgement against the wholly owned subsidiary. Accordingly the Company has recorded a provision in the amount of the asserted liquidated damages. The Company will continue to vigorously defend its position. The Company has appealed the court ruling including a counter-claim against the farmor for damages relating to breach of contract. The Company has filed affidavits with the courts as to the financial condition of the subsidiary which blocks any further attempts at collection on the judgement. The appeal

and counter-claim is still pending in the court system.

The Company does not have sufficient capital to satisfy it's near term obligations to fund the development of the Maverick County Project, repay its long-term debts due in 2021 or pay any liabilities arising from matters discussed above. 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 sell assets and/or raise additional capital or seek other strategic alternatives to meet its obligations none of which is assured.

Off Balance Sheet Arrangements

Except as described herein, there are no off-balance sheet arrangements to which the Company is committed.

Key Management Personnel Compensation

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

	Six months ended July 31,	
	2017	**2016**
Short-term compensation		
CEO	$ 180,000	$120,000
CFO	35,501	98,825[1]
COO	-	130,860
VP Exploration	89,250	81,733
VP Geosciences	48,150	60,133
Secretary	15,968	14,183
Recoveries from consulting and management services revenues	(189,819)	(334,295)
	$ 187,795	$172,039

1) Previous CFO

As at July 31, 2017 and 2016:

(a) Convertible notes held by key management personnel totalled CAD $3,230,000 (2016 - CAD $3,230,000). No interest was paid on these convertible notes in 2017 and 2016

(b) During the six months ended July 31, 2017, salaries and benefits expense was reduced by $189,819 as a result of consulting revenues compared to a reduction of $334,295 for the six months ended July 31, 2016.

Proposed transactions

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

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.

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.

Critical accounting estimates

The preparation of the consolidated 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.

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.

Accounts receivable

Accounts receivable are recorded at the estimated recoverable amount, which involves the estimate of uncollectible accounts.

Risk Factors

Management of the Company considers the following risks to be the most significant in connection with the business and outlook for the Company, but such risks do not necessarily comprise all those associated with the Company's operations. Additional risks and uncertainties not currently known to management of the Company may also have an adverse effect on the Company's business. If any of these risks actually occur, the Company's business, financial condition, capital resources, results and/or future operations could be materially adversely affected. In such a case, the market value of the securities of the Company could decline and investors may lose all or part of their investment.

Additional Funding Requirements and Going Concern

As of January 31, 2017, the Company had working capital of approximately $1.6 million. Additionally, the Company had negative cash flow from operating activities from continuing operations of $665,078 and $2,137,261 for the six months ended July 31, 2017 and 2016, respectively. Terrace's financial resources will not be sufficient to fund its long-term convertible note obligations and ongoing activities beyond the near term (see commitments described under "Exploration and Development Assets"). 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 sell assets and/or raise additional capital to meet its note obligations and to carry out its future oil and gas acquisition, exploration and development activities. Failure to obtain such capital on a timely basis could cause the Company to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. Any additional financing is likely to involve the issuance of securities which could be substantially dilutive.

The Company's ability to meet its current and future debt obligations and to fund its operations, including its obligations in order to earn into its project interests, will depend on numerous factors, including the ability to sell assets and/or raise additional capital, the success of its acquisition activities, development and exploration drilling success, cost of lease extensions and renewals, the cost and rates of success of re-completing or drilling wells, future production levels, the terms (including price) and conditions that it is able to negotiate with purchasers of production

from its properties, and the results of exploration activities. None of these factors can be predicted with certainty. Accordingly, the timing and amount of required capital may vary from management expectations. In addition, the Company may be required by the holders of the outstanding convertible promissory notes to pre-pay the outstanding principal amount owing under the notes if an event of default under the notes occurs. As a result, in such circumstances the Company may be required to pay the entire outstanding principal owing on the notes in advance of the maturity date of April 2, 2021, failing which the note holders could take action to realize on their general security interest over the Company's assets. Further, because the Company's operations are conducted through U.S. subsidiaries, the Company's ability to meet its debt service obligations with cash from operations will depend on generating cash flows from operations of its U.S. subsidiaries and may be subject to contractual or other restrictions and other business considerations.

Any additional equity financing will be dilutive to the holders of the Company's outstanding common shares and may not be on terms that the Company finds attractive, if available at all. Any additional debt financing, if available, may restrict the Company's future financing and operating activities. The Company may be unable to obtain additional financing on acceptable terms if market and economic conditions, the financial condition or operating performance of the Company or investor sentiment are unfavourable. If the Company's cash flow is insufficient to meet its current and future debt obligations or if the Company fails to obtain sufficient funds for operations and earn in obligations on a timely basis, the Company may have to forfeit its interest in certain properties, sell assets, miss certain acquisition opportunities, and reduce or terminate its acquisition, exploration and development programs, which would have a material adverse effect on the Company's results of operations and could result in a loss of some projects. The inability of the Company to meet its current and future debt obligations or to fund its operations could have a material adverse effect on the Company's financial condition, results of operations and prospects.

Prices and Markets for Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which will be beyond the control of the Company. World prices for oil and natural gas have fluctuated widely in recent years and have dropped precipitously since late 2014. The recent decline in prices has resulted in a significant reduction of net production revenue. Additional decreases could result in further decreases of revenue. Certain wells have become uneconomic as a result of a decline in world oil prices or natural gas prices, leading to a reduction in the volume of the Company’s oil and gas reserves. Additional material declines would result in more wells becoming uneconomic with corresponding reductions to reserves. The Company might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company’s future net production revenue, causing a reduction in its oil and gas acquisition and development activities. Prices for oil and gas are subject to large fluctuations in response to relatively minor changes in the supply of and demand for oil and gas, market uncertainty and a variety of additional factors beyond the control of the Company. These factors include economic conditions, in the United States and Canada, the actions of OPEC, governmental regulation, political stability in the Middle East and elsewhere, the foreign supply of oil and gas, risks of supply disruption, the price of foreign imports and the availability of alternative fuel sources. Any substantial and extended decline in the price of oil and gas would have an adverse effect on the Company’s carrying value of its reserves, borrowing capacity, revenues, profitability and cash flows from operations and may have a material adverse effect on the Company’s business, financial condition, results of operations and prospects.

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on future exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. The Company, through its subsidiaries, has the right to earn working interests in various oil and gas properties described herein. To earn such interests the Company must incur certain specified expenditures to evaluate and complete a number of prospective wells capable of producing oil and gas in paying quantities. No assurance can be given that the Company will be successful in completing wells capable of producing oil and gas. The long-term commercial

success of the Company depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Without the continual addition of new reserves, any existing reserves the Company may have at any particular time and the associated production if any there from will decline over time as the reserves are exploited. A future increase in the Company's reserves will depend not only on its ability to explore and develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. No assurance can be given that the Company will be able to continue to locate satisfactory properties for acquisition or participation. Exploration and development activities may be delayed or adversely affected by factors outside the control of the Company including adverse climatic and geographic conditions, labour disputes, compliance with governmental requirements, shortage or delays in installing and commissioning plant and equipment or import or customs delays. Drilling may involve unprofitable efforts, not only with respect to dry wells, but also with respect to wells, though yielding some oil or gas, are not sufficiently productive to justify commercial development or cover operating and other costs. Oil and natural gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts, cratering, sour gas releases and spills, each of which could result in substantial damage to oil and natural gas wells, production facilities, other property and the environment or in personal injury.

No Assurance of Title

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

Permits and Licenses

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

Hydraulic Fracturing

Hydraulic fracturing is a common practice that is used to stimulate production of hydrocarbons from shale and tight formations. The projects in which the Company is currently engaged are heavily dependent on hydraulic fracturing. The process involves the injection of water, sand and chemicals under pressure into rock formations to fracture the surrounding rock and stimulate production.

Certain U.S. states, including Texas, and municipalities have adopted, or are considering adopting, regulations that have imposed, or that could impose, more stringent permitting, disclosure, disposal and well construction requirements on hydraulic fracturing operations. If new laws or regulations that significantly restrict or regulate

hydraulic fracturing are adopted, such legal requirements could cause project delays and make it more difficult or costly for the Company to perform fracturing to stimulate production from a formation. The development of natural gas and oil reserves from shale and tight formations in which the Company has or may in the future have an interest may not be commercial without the use of hydraulic fracturing, and therefore any restrictions imposed on the Company's use of hydraulic fracturing could have a material adverse effect on the Company's cash flows and financial condition. Restrictions on hydraulic fracturing could reduce the amount of natural gas and oil that the Company is ultimately able to produce from its reserves.

Reserve Estimates

There are numerous uncertainties inherent in estimating quantities of oil, natural gas and natural gas liquids reserves and resources and associated cash flows, including many factors beyond the Company's control. In general, estimates of economically recoverable oil and natural gas reserves and the future net cash flows from them are based upon a number of variable factors and assumptions, such as historical production from the properties, production rates, ultimate reserve recovery, timing and amount of capital expenditures, marketability of oil and natural gas, royalty rates, the assumed effects of regulation by governmental agencies and future operating costs, all of which may vary from actual results. The Company's actual production, revenues, taxes and development and operating expenditures with respect to its reserves will vary from estimates thereof and such variations could be material.

Lack of Adequate Insurance

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

Competition

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

Reliance upon Third Party Operators and Risks Associated with Joint Operating Agreements

The Company is not the operator on any of its projects. The Company therefore has limited ability to exercise influence over operations of the projects or their associated costs. The Company's dependence on the operator and other working interest owners and its limited ability to influence operations and associated costs could materially and adversely affect the Company's financial performance. The success and timing of the Company's activities on assets operated by others therefore will depend upon a number of factors outside of the Company's control, including the timing and amount of capital expenditures, timing and amount of operating and maintenance expenditures, the operator's expertise and financial resources, approval of and funding by other participants, selection of technology and risk management practices.

In addition, the Company owns certain of its interests, including its interests in the Maverick County Project, through joint venture or similar arrangements. Joint ventures involve risks not otherwise present when exploring and developing properties directly, including, for example, that the joint venture partner may not pay its share of obligations, the Company may incur liabilities as a result of an action taken by its joint venture partners and the Company may be required to devote significant management time to the requirements.

Disputes with third party operators, joint venture partners and other participants in projects may result in delays, litigation or operational impasses. The risks described above or the failure to resolve disagreements could result in significant cost and delay, or adversely affect the ability of the parties to operate and develop the relevant projects, which would have a material adverse effect on the Company.

Environmental Risks

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

Availability of Drilling Equipment and Access Restrictions

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

Global Financial Conditions

Following the onset of the credit crisis in 2008, global financial conditions were characterized by extreme volatility and several major financial institutions either went into bankruptcy or were rescued by governmental authorities. While global financial conditions subsequently stabilized, there remains considerable risk in the system given the extraordinary measures adopted by government authorities to achieve that stability. The deteriorating financial condition of certain government authorities has significantly increased the potential for sovereign defaults in a number of jurisdictions, including within the member states of the European Union. Global financial conditions could suddenly and rapidly destabilize in response to future economic shocks, as government authorities may have limited resources to respond to future crises. Future economic shocks may be precipitated by a number of causes, including changes in commodity prices, geopolitical instability and natural disasters.

Global financial conditions continue to be subject to increased volatility. Many industries, including the oil and gas industry, are impacted by global market conditions. Some of the key impacts of financial market turmoil can include contraction in credit markets resulting in a widening of credit risk, devaluations and high volatility in global and specifically natural resource equity markets, commodity, foreign exchange and precious metal markets, and a lack of market liquidity. A slowdown in the financial markets or other economic conditions, including but not limited to, reduced consumer spending, increased unemployment rates, deteriorating business conditions, inflation, deflation, volatile fuel and energy costs, increased consumer debt levels, lack of available credit, lack of future financing, changes in interest rates and tax rates may adversely affect the Company's operations and business plans. Any of these factors may impact the ability of the Company and its joint venture partners or potential partners to obtain equity or debt financing in the future and, if obtained, on favourable terms. Additionally, any such occurrence

could cause decreases in asset values that are deemed to be other than temporary, which may result in impairment losses.

Geo Political Risks

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

Transportation Costs

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

Capacity of Pipelines, Refineries and Natural Gas Processing Facilities

Although expansion projects are ongoing, the availability of sufficient marketing capacity continues to affect the oil and natural gas industry and limit the ability to produce and to market natural gas production. The rapid expansion of production in the Company's core area may create temporary disruptions in the capacity of marketing infrastructure.

Reliance on Key Individuals

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

Conflicts of Interest

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

directors will primarily consider the degree of risk to which the Company may be exposed and its financial position at that time.

Financial Instruments

The Company has classified its financial instruments as follows:

- Cash – as FVTPL;
- Accounts receivable and operators bond – as loans and receivables; and
- Accounts payable and accrued liabilities 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 accounts receivable, accounts payable and accrued liabilities, and liabilities associated with assets held-for-sale approximate their fair values due to the short-term maturity of these financial instruments. The fair value of the operators bond also approximates its carrying value. 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 the market prices. Market risk is comprised of three types of risk: interest rate risk, foreign currency risk and other price risk.

(i) Interest rate risk

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

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

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

(ii) Foreign currency risk

Foreign currency risk is the risk that the future cash flow of financial instruments will fluctuate as a result of changes in foreign exchange rates. The Company's 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 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:

	July 31, 2017 (USD)	January 31, 2017 (USD)
Cash	$ 1,813,084	$ 2,485,985
Accounts receivable	73,056	10,650
Operator's bond	25,000	25,000
Accounts payable and accrued liabilities	(531,653)	(526,810)
Net	$ 1,379,487	$ 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 $68,974 (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. 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 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 July 31, 2017, the Company had cash of $1,868,170, accounts receivable of $87,411, and current liabilities of $531,653. Current liabilities of $31.653 are due within three months of July 31, 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 the BTLP Partnership, 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 determined that its working capital and available resources combined with future cash flow from operations will not be sufficient to fund its share of the agreed-upon estimated costs of proposed future development activities. As a consequence, the Company has entered into an arrangement with its partner wherein its partner will provide capital to fulfill the obligations of the BTLP partnership in exchange for dilution of the Company's partnership interest.

Shareholder's Equity and Outstanding Share Data

The authorized share capital of the Company consists of an unlimited number of common shares. As of July 31, 2017 and the date of this report, there were 88,494,821 common shares outstanding.

During the periods ended July 31, 2017 and July 31, 2016, the Company did not issue any common shares.

As of the date of this report, the Company had no stock options outstanding:

Restricted Share Units

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, restricted share units ("RSUs"). The aggregate number of common shares of the Company that may be issued under the plan may not exceed 3,682,182 shares. 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 12-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 and 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 has issued 700,000 RSUs outstanding as of July 31, 2017 (January 31, 2017 - 700,000). 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.

Reserves Data and Other Oil and Gas Information

Our independently prepared reserves assessment and evaluation of oil and gas properties effective January 31, 2017 have been prepared in accordance with mandated National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities of Canadian Securities Administrators*. A summary of our reports is available on SEDAR at www.sedar.com.

Internal Controls Over Financial Reporting

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

Contingencies

There are no contingent liabilities.

Management's Responsibility For Financial Statements

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

Other MD&A Requirements

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

Directors and Officers

David Gibbs	President, Chief Executive Officer and Director
Dan Carriere	Director and Non-Executive Chairman
Eric Boehnke	Director and Executive Vice Chairman
Murray Oliver	Director
William McCartney	Director
Ken Shannon	Director
Jennie Choboter	Chief Financial Officer
William McMoran	Vice President Exploration
Daniel Morris	Vice President Geoscience
Anthony Alvaro	Vice President Corporate Development
Deborah Cotter	Secretary

Contact Person

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