TERRACE ENERGY CORP.
(the "Company" or "Terrace")
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE COMPANY'S FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE YEARS ENDED JANUARY 31, 2014 AND 2013

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 of 51-102 as of May 29, 2014 and should be read in conjunction with the audited consolidated financial statements for the years ended January 31, 2014 and 2013 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. The information provided is this document 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 and the documents referenced in this discussion and analysis contain forward-looking information which include, but is not limited to, statements with respect to future activities of the Company, the Company's plans for its oil and gas properties, the future financial or operating performance of the Company, its subsidiaries and its projects, the timing and amount of estimated future capital required, operating and capital expenditures, costs and timing of future exploration, government regulation of oil and gas operations, environmental risks, reclamation expenses, title disputes or claims, limitations of insurance coverage, the timing and possible outcome of pending litigation and regulatory matters. These statements relate to analyses and other information that are based on forecasts of future results, estimates of amounts not yet determinable and assumptions of management. 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"). Readers are cautioned not to place undue reliance upon these forward looking statements.

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 TSXV 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.

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 unconventional 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 1012-1030 West Georgia Street, Vancouver, British Columbia V6E 2Y3. Its 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 400, 202 Travis Street, Houston, Texas 77002 where all its operating activities are managed.

The Company's common shares trade on the TSX Venture Exchange (the "Exchange") under the symbol "TZR", on the OTCQX in the United States under "TCRRF" and on the Frankfurt Exchange under "2TR".

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%
Terrace Cutlass LLC	USA	100%
Terrace STS LLC	USA	100%
Terrace Investment Holdings Inc.	USA	100%

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

Exploration and Evaluation Assets

The following is a brief description of the Company's principal exploration and evaluation properties:

STS Olmos

In November 2011, the Company entered into an agreement, through a wholly-owned subsidiary, to acquire varying working and net revenue interests, which average 26.88% and 20.16%, respectively, in approximately 14,400 gross mineral acres (3,875 net mineral acres) in LaSalle and McMullen Counties, Texas and an evaluation well. The aggregate purchase price was $1,001,269.

During fiscal 2013, the Company participated in the reentry and horizontal extension of the suspended well and drilling of two additional development wells, both of which were drilled horizontally with lateral lengths averaging approximately 4,500 feet. Each of these wells was completed in the Olmos tight sandstone formation using multi-hydraulic fracturing techniques. The Company's share of the aggregate costs to drill, complete and place into production these three wells was $6,760,921. These costs and $60,000 of the acreage lease acquisition costs were previously transferred from Exploration and Evaluation assets to Property and Equipment.

The Company participated in drilling four additional horizontal Olmos development wells during fiscal 2014, bringing the total number of wells drilled on its leasehold interests that comprise the STS Olmos Project to seven. The Company's share of the aggregate costs, to drill, complete and place into production these wells was $10,273,308. These costs and $80,000 of the acreage lease acquisition costs were transferred from Exploration and Evaluation assets to Property and Equipment. One additional well in which the Company did not have a working interest was also drilled on the project acreage. This well provided valuable technical data.

A summary of aggregate capital costs to drill, complete and place into production the seven wells and cumulative gross revenues associated with each of wells are as follows:

Well	Working Interest	Net Revenue Interest	Completion Date	Number of Days in Production to January 31, 2014	Cost	Cumulative Revenues
STS 1-667	16.87%	12.65%	February 10, 2012	721	$ 1,569,653	$1,213,474
SP5 #1-47H	33.33%	25.00%	October 18, 2012	470	2,651,435	2,315,423
SP5 #2-47H	33.33%	25.00%	October 20, 2012	468	2,726,883	2,088,581
SP5#1-2H [(1)]	33.33%	25.00%	August 1, 2013	183	2,606,067	33,764
SP5#1-16H	33.33%	25.00%	September 17, 2013	136	2,486,010	928,613
STS1-17H	16.87%	12.50%	October 13, 2013	110	1,322,056	620,340
SPH1-27H	37.20%	27.90%	October 25, 2013	98	2,871,466	1,450,752
Miscellaneous						64,144
					$ 16,233,570	$ 8,715,091

(1) Well SP5#1-2H was fracture stimulated using an experimental hydrocarbon frac fluid rather than water, which has resulted in much slower than expected recovery of in situ oil. The Company continues to monitor and evaluate the well.

The net sale of hydrocarbon production from these seven wells from their completion date to January 31, 2014 totaled 78,860 barrels of oil, 138,590 thousand cubic feet of gas and 1,031,378 gallons of natural gas liquids, which is the equivalent of 126,515 BOEs in the aggregate.

The Company has secured its working and net revenue interests in the initial 3,875 net acres of the project acreage subject to participation in the development of additional wells proposed from time to time by the project's operator, BlackBrush Oil and Gas, LP. Based on the results of drilling activity to date, the Company and the operator expect to drill several more development wells in the 2014 calendar year.

In October 2013, the Company entered into agreements, through a wholly-owned subsidiary, to earn a 100% working interest and a 75% net revenue interest in the "Olmos" formation within an additional 1,230 net mineral acres adjacent to the Company's existing leasehold interest. The Company made an initial payment of $492,148 and was required to drill an initial well prior to June 1, 2014 and two additional wells prior to October 1, 2016 (collectively, the "Earning Wells"). In addition, the Company is required to pay the seller a further $123,037 upon completion of each of the three Earning Wells. The requirement to initiate the first Earning Well has been extended pending clarification of certain underlying title matters. As at the date of his report, these issues are still pending resolution.

Upon satisfaction of the provisions set out in the previous paragraph, the Company's leasehold interests in the project acreage will increase from 3,875 net mineral acres to 5,105 net mineral acres.

BlackBrush Terrace LP

The Company and its partner, BlackBrush Oil & Gas, LP ("BlackBrush") organized a special purpose limited partnership, the BlackBrush Terrace LP (the "SPLP"), to acquire a 50% working interest (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 newly emerging Pearsall Shale Trend as well as the Eagle Ford Shale, Buda Limestone and several other intervals of Cretaceous age formations which have been proven productive on a regional basis.

Under the limited partnership agreement governing the SPLP, a Delaware limited partnership, the Corporation and BlackBrush have agreed that each party must fund its 50% share of the costs to drill and complete four horizontal wells in the Pearsall Shale and one horizontal well in the Eagle Ford Shale (collectively, the "Obligation Wells") or forfeit their respective interest in the SPLP and each party's initial 50% interest in the SPLP may be adjusted, in defined circumstances, where one party finances a disproportionate share of costs to drill and complete additional wells. Similarly, allocations of profit and losses of the SPLP, may be adjusted in defined circumstances, which may require approval of the general partner. The Corporation and BlackBrush organized a special purpose Delaware limited liability company, BlackBrush Terrace GP, LLC (the "SPGP"), to act as the general partner of the SPLP. The Corporation and BlackBrush each have a 50% interest in the SPGP and 50% representation on its board of directors. Matters to be approved by the board of directors are determined by majority, super-majority or unanimous vote, depending on the matter; however, in the case of deadlocks certain matters can be referred for binding determination by a third party arbiter.

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

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

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

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

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

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

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

7. Shell Oil has the right, but not the obligation to assume operatorship of any formation in which production has been established at any time within two years after the later of (i) the Carry Payment being made in full and subsequent assignment of 50% of Shell Oil's interest in the subject leases or (ii) establishment of production from a given formation.

Maverick County Project

The Maverick County Project is located on a group of mineral leases covering approximately 147,000 gross mineral acres in eastern Maverick and western Zavala Counties, in south Texas. The corridor in which the project is situated is commonly referred to as the Pearsall Shale fairway, which extends all the way from Gonzales County in south Texas to Chittim Ranch.

Production records from several previously drilled vertical wells confirm the presence of producible oil and gas in the Pearsall Shale and Buda Limestone formations and the existence of the Eagle Ford, San Miguel, Austin Chalk and the Georgetown formations within the project acreage. Most notably, the Eagle Ford Shale formation is located in the western extension of the Eagle Ford Shale fairway in the pure oil-producing window, with a low gas-to-oil ratio.

At January 31, 2014, the Company advanced the aggregate sum of $15,681,920 representing its share of costs to organize, acquire and fund certain agreed upon exploration and evaluation activities to-date including the following:

The SPLP successfully drilled its first obligation well, the Chittim #1-H, as a Pearsall Shale evaluation well. The well was spudded on April 1, 2013 and drilled to a total depth of 11,620 feet including a horizontal section of approximately 4,700 feet within the Pearsall Shale with positive hydrocarbon indicators throughout the drilling process. During the drilling operations, extensive petrophysical testing was also conducted on several potentially productive strata within the Cretaceous age formations above the Pearsall Shale with positive hydrocarbon indicators in multiple formations including the Eagle Ford Shale and Buda Limestone. The results of these analyses are currently under review for planning further evaluation drilling in these shallower intervals. Completion and evaluation work is currently underway on the horizontal lateral portion of the well in the Pearsall Shale formation. The SPLP has conducted six stages of hydraulic fracturing, the results of which are under study in order to optimize additional completion intervals. Additional testing on this well will be deferred until further Pearsall evaluation wells are drilled on the project.

In August 2013, the SPLP successfully re-entered and completed an Eagle Ford Shale well, SWEPI Chittim #F-1H, which was previously drilled and shut in by Shell Oil in 2011. The well has been placed into production using temporary artificial lift equipment at a current rate of approximately 60 BOE per day.

As at January 31, 2014, the SPLP accrued revenues on the sale of 4,981 BOE and the Company’s share of SPLP net income was $52,053.

The SPLP also initiated work on a follow-up evaluation well to test the Eagle Ford and Buda Limestone Formations. The Chittim Heirs #2H was spud on October 4, 2013 and drilled to a vertical depth of 5,300 feet in order to gather petrophysical testing data including core samples through the objective formations. The well was subsequently plugged back to approximately 4,850 feet and a 4,100 foot horizontal lateral was drilled in the Eagle Ford Shale. The well was successfully completed utilizing a multi-stage hydraulic stimulation treatment utilizing a hydrocarbon-based, rather than water-based fracturing fluid. After recovery of the fracturing fluid, the well has been placed on artificial lift at a rate of approximately 100 BOPD. Initial production rates are not necessarily indicative of long-term performance or of ultimate recovery.

The SPLP is currently formulating plans for its 2014 evaluation drilling program including testing the Buda Limestone using underbalanced drilling techniques as well as additional tests of the Eagle Ford Shale and Pearsall formations.

Northwest AWP Project

In January, 2014, the Corporation entered into agreements, through a wholly-owned subsidiary, to earn a 33.34% working interest and a 24.59% net revenue interest in certain leases covering approximately 199 gross mineral acres in McMullen County, Texas as well as an option to acquire a 33.34% working interest and a 24.59% net revenue interest in adjacent leases covering an additional 3,418 gross mineral acres. The interests to be acquired in this project are depth limited to the Olmos tight Sandstone formation.

The purchase consideration consisted of a payment of $33,173, all of which the Corporation has paid and a commitment to participate in the development of an evaluation well to be drilled in Q2 2014. The estimated cost to the Corporation for this evaluation well is approximately $1,833,853. Upon completion of the evaluation well, the Corporation will have a 90 day option to acquire a 33.34% working interest and a 24.59% net revenue interest in approximately 3,400 gross mineral acres (1,133 net mineral acres) for an additional payment of approximately $686,454.

The Northwest AWP Project is located in the nearby vicinity to the Corporation's STS Olmos Project and possesses similar geological characteristics. If the initial evaluation well is successful, it is estimated that the option acreage will contain approximately twelve additional prospective drilling locations.

Big Wells Project

Subsequent to January 31, 2014, the Corporation entered into agreements, through a wholly-owned subsidiary, to earn a 75% working interest and a 56.25% net revenue interest in certain leases covering approximately 10,130 gross mineral acres in Dimmit and Zavala Counties, Texas. The interests to be acquired in this project are depth limited to the Buda Limestone formation.

Under the terms of the agreements, the Corporation has the option to drill a series of "Earning Wells", each of which will secure the Corporation's interest in a 640 gross mineral acre tract. The Corporation will be required to pay 100% of the capital costs of each Earning Well and will receive 100% of the gross revenues from such Earning Well until it has recovered its capital investment. Upon capital recovery, the farmor will be offered an election to accept its 25% working interest, 18.75% net revenue interest share of the Earning Well or exchange its rights to its working interest for a 5% overriding royalty interest. Depending on the farmor’s election, the Corporation will secure either a 75% working interest / 56.25% net revenue interest or a 100% working interest / 70% net revenue interest in each earned 640 acre tract.

The Corporation is required to spud its initial Earning Well prior to August 1, 2014. Subsequent Earning Wells must be spud no more than 120 days after the completion of the previous Earning Well in order for the Corporation to continue earning acreage under these agreements. Once a 640 acre tract is earned, the Corporation will continue to hold that acreage under customary leasehold terms regarding on-going production and / or subsequent operations. There is no penalty for non-performance other than the loss of opportunity to continue earning additional acreage.

Cutlass

In November, 2011 and February, 2012, the Company entered into agreements, through a wholly-owned subsidiary, to earn a 30% working interest and a 22.5% net revenue interest in certain leases covering 3,395 gross acres in Dimmit and LaSalle counties.

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

As the proposed sale meets the definition of “assets held for sale” under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, the assets and liabilities associated with the Company’s interests in Cutlass have been reclassified from their respective balance sheet classifications to “assets held for sale” and “liabilities associated with assets held for sale”. The Company is required to recognize assets held for resale at the lower of their carrying value and fair value less costs to sell. Management has determined that the carrying value of the Cutlass project exceeded its fair value and therefore recognized an impairment charge of $3,747,259 in the last fiscal quarter.

Selected Annual Information

The following financial represents selected information of the Company for the three most recently completed financial years:

	Year ended January 31, 2014	Year ended January 31, 2013	Year ended January 31, 2012
Revenue	$ 6,007,979	$ 3,415,104	$ -
Net loss for the year	$ (6,575,492)	$ (121,722)	$ (1,265,463)
Basic and diluted loss per share	$ (0.10)	$ (0.00)	$ (0.03)
Total assets	$ 53,863,687	$ 16,319,564	$ 5,553,285
Total long-term liabilities	$ 32,506,578	$ 8,016	$ -
Cash dividends per share	$ -	$ -	$ -

The revenue for the year ended January 31, 2014 was a primarily a result of oil and gas sales. The losses for the year ended January 31, 2014 primarily relate to operating expenses which include production and operating, royalties, depreciation, depletion and accretion, interest and impairment of assets held for sale. Included in the losses in fiscal 2014 are non-cash transactions of depreciation, depletion and accretion, share-based payments and impairment of assets held for sale are $1,968,323, $426,293 and $3,747,259 respectively.

The revenue for the year ended January 31, 2013 was a primarily a result of oil and gas sales. The losses for the year ended January 31, 2013 primarily relate to direct operating expenses which include production and operating, royalties and depreciation, depletion and accretion. Included in the losses in fiscal 2013 are non-cash transactions of impairment of oil and gas properties and share-based payments are $135,000 and $393,100 respectively.

The losses for the year ended January 31, 2012 primarily relate to administrative expenses, business investigations, consulting and project investigation costs resulting from the acquisition of a qualifying transaction and the transition to an operating company. Included in the losses in fiscal 2012 are non-cash transactions of impairment of oil and gas properties and share-based payments of $229,447 and $280,173 respectively.

Results of Operations

For the years ended January 31, 2014 and 2013

The Company began the business of acquiring, exploring and developing oil and gas property interests in June 2011. The Company's first revenues derived from operations were earned during the year ended January 31, 2013.

Net loss for the year ended January 31, 2014 was $6,575,492 compared to a loss of $121,722 for the year ended January 31, 2013. The results are summarized as follows:

	2014	2013
Oil & Gas revenues	$ 6,007,979	$ 3,415,104
Direct operating expenses	613,300	220,772
Royalties	289,166	164,256
Depreciation, depletion and accretion	1,968,323	845,006
Operating Income	3,137,190	2,185,070
Equity income in partnership	52,053	-
	3,189,243	2,185,070
General and administrative expenses	3,256,021	1,700,822
Foreign exchange (gain) loss	(570,213)	77,870
Interest expense	2,905,375	-
Share-based payments	426,293	393,100
Impairment of exploration and evaluation assets	-	135,000
Impairment of assets held for sale	3,747,259	-
	9,764,735	2,306,792
Net loss for the year	$ (6,575,492)	$ (121,722)

Oil and gas sales for the year ended January 31, 2014 were $6,007,979 compared to $3,415,104 for the year ended January 31, 2013. The increase in revenues was the result of additional wells placed into production on the Company's STS Olmos project.

The Company's aggregate share of production from producing wells for the year ended January 31, 2014 was approximately 74,452 barrels of oil and liquids at an average price of $75.76 per barrel and 114,912 thousand cubic feet of natural gas at an average price $3.19 per thousand cubic feet as compared to the previous year of approximately 30,373 barrels of oil and liquids at an average price of $98.23 per barrel and 45,527 thousand cubic feet of natural gas at an average price of $3.29 per thousand cubic feet.

Direct operating expenses for the year ended January 31, 2014 was $613,300, compared to $220,772 for the year ended January 31, 2013. Total depletion and accretion expense for the year ended January 31, 2014 was $1,968,323 compared to $845,006 for the year ended January 31, 2013. Royalties were $289,166 for the year ended January 31, 2014 compared to $164,256 for the year ended January 31, 2013. These expenses generally increased due to increased production activity during the year.

General and Administrative expenses for the year ended January 31, 2014 were $3,256,021 compared to $1,700,822 for the year ended January 31, 2013. The increase in these expenses is primarily attributable to an increase in: 1) office costs, including rent associated with establishing a new office in Vancouver and expanding the office in Houston; 2) executive and other salaries due to hiring of additional employees in Houston and a cash bonus payment to the CEO; 3) professional fees for legal services in connection with continuous disclosure filings and general corporate matters; 5) transfer agent and Exchange fees resulting from increased activity during the year and 6) investor relations activities, including increased travel and shareholder communication expenses.

Interest expense for the year ended January 31, 2014 was $2,905,375 compared to $nil for the year ended January 31, 2013, which is substantially attributable to the convertible notes the Company issued during the current year. Interest expense includes a non-cash expense of $530,462, which represents accretion of the convertible notes during the year.

Foreign exchange gains for the year ended January 31, 2014 were $570,213 compared to a loss of $77,870 for the year ended January 31, 2013. The change in foreign exchange was due to fluctuations in the USD exchange rate during the year.

Share-based payments for the year ended January 31, 2014 were $426,293 compared to $393,100 for the year ended January 31, 2013. The increase is primarily due to additional share options vesting in the year and the issuance of 80,000 common shares with a fair value of $140,000, as partial compensation to the Company's president.

Impairment of assets held for sale for the year ended January 31, 2014 was $3,747,259 compared to $nil for the year ended January 31, 2013. Management has evaluated the expected fair value less costs to sell and determined that it is lower than the carrying value, based on initial expressions of interest from potential acquirers, and the value reported in a reserve report as of January 31, 2014. Based on these factors, assets held for sale have been remeasured at $10,000,000, being the lower of carrying value and fair value less costs to sell.

For the three months ended January 31, 2014 and 2013

Net loss for the three months ended January 31, 2014 was $3,640,635 compared to net income of $106,951 for the three months ended January 31, 2013. The results are summarized as follows:

	2014	2013
Oil & gas revenues	$ 2,995,683	$ 2,322,331
Direct operating expenses	429,549	221,367
Depreciation, depletion and accretion	807,462	799,961
Operating income	1,758,672	1,301,003
Equity income in partnership	(85,609)	-
	1,673,063	1,301,003
General and administrative expenses	1,881,996	900,139
Interest expense	945,929	-
Foreign exchange (gain) loss	(373,196)	151,871
Share-based payments	57,639	142,042
Impairment of assets held for sale	3,747,259	
	5,313,698	1,194,052
Net income (loss) for the period	$ (3,640,635)	$ 106,951

Oil and gas sales for the three months ended January 31, 2014 were $2,995,683 compared to $2,322,331 for the three months ended January 31, 2013.

The Company's aggregate share of sales from these wells for the three months ended January 31, 2014 was approximately 36,997 barrels of oil and liquids at an aggregate average price of $74.79 per barrel of oil equivalent and 60,912 thousand cubic feet of natural gas at an average price of $3.09 per thousand cubic feet as compared to the previous period of approximately 19,727 barrels of oil and liquids at an average price of $99.15 per barrel of oil equivalent and 35,857 thousand cubic feet of natural gas at an average price $3.48 per thousand cubic feet.

*Direct operating expense*s inclusive of royalties was $429,549 for the three months ended January 31, 2014 compared to $221,367 for the three months ended January 31, 2013, net of depreciation, depletion and accretion expenses of $807,462 and $799,961 respectively.

General and Administrative expenses for the three months ended January 31, 2014 were $936,135 compared to $900,139 for the three months ended January 31, 2013. These expenses are comprise primarily of office costs, including rent, executive and other salaries, professional fees for legal and audit services, transfer agent and Exchange fees and investor relations activities.

Interest expense for the three months ended January 31, 2014 were $945,929 compared to $nil for the three months ended January 31, 2013 which is primarily attributable to the convertible notes the Company issued. Interest expense includes a non-cash expense of $177,004, which represents accretion of the convertible notes during the period.

Foreign exchange gain for the three months ended January 31, 2014 was $373,196 compared to a loss of $151,871 for the three months ended January 31, 2013. The change in foreign exchange was due to fluctuations in the USD exchange rate during the period.

Share-based payments for the three months ended January 31, 2014 were $57,639 compared to $142,042 for the three months ended January 31, 2013 due to the timing of granting stock options and their relate vesting periods during the current period compared to the prior period.

Impairment of assets held for sale for the three months ended January 31, 2014 was $3,747,259 compared to $nil for the three months ended January 31, 2013. Management has evaluated the expected fair value less costs to sell and determined that it is lower than the carrying value, based on initial expressions of interest from potential acquirers, and the value reported in a reserve report as of January 31, 2014. Based on these factors, assets held for sale have been remeasured at $10,000,000, being the lower of carrying value and fair value less costs to sell.

Summary of Quarterly Results

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

	January 31, 2014	October 31, 2013	July 31, 2013	April 30, 2013
Revenue[1]	$ 2,995,683	$ 1,390,636	$ 765,649	$ 856,011
Net income (loss)	(3,640,635)[2]	(1,898,461)[3]	(498,568)[4]	(537,828)
Exploration and evaluation assets[9]	1,231,887	1,754,179	10,878,981	8,757,149
Property and equipment[9]	13,665,655	13,786,749	9,615,819	5,810,585
Assets held for sale[11]	10,000,000	15,073,427	-	-
Investment in partnership[10]	15,681,920	13,761,728	12,900,434	12,915,830
Total assets	53,863,687	52,398,640	53,026,973	39,699,459
Loss per share – basic and diluted	(0.05)	(0.03)	(0.01)	(0.01)

	January 31, 2013	October 31, 2012	July 31, 2012	April 30, 2012
Revenue[1]	$ 2,322,331	$ 332,815	$ 202,868	$ 557,090
Net income (loss)	106,951[5]	(200,670)[6]	(240,756)[7]	212,753[8]
Exploration and evaluation[9]	6,737,039	6,370,695	7,974,638[10]	3,224,976
Property and equipment[9]	6,047,528	7,155,849[11]	1,471,266	1,316,761
Total assets	16,319,564	15,734,818	15,831,189	9,471,838
Income (loss) per share – basic and diluted	(0.00)	(0.00)	(0.00)	0.00

Notes:

1) Revenue is primarily a result of oil and gas sales which varies each period depending on the number of wells in production.
2) Net income during this period includes non-cash deductions of $57,639 for share–based payments, $807,462 for depletion and accretion expenses, and $3,747,259 for impairment of assets held for sale.
3) Net loss during this period includes non-cash deductions of $64,460 for share–based payments, $665,509 for depletion and accretion expenses.
4) Net loss during this period includes non-cash deductions of $231,077 for share–based payments, $220,773 for depletion and accretion expenses
5) Net income during this period includes non-cash deductions of $142,042 for share–based payments, $94,879 for depletion and accretion expenses
6) Net loss during this period includes non-cash deductions of $104,787 for share–based payments, $24,955 for depletion and accretion expenses and $140,000 impairment charge
7) Net loss during this period includes non-cash deductions of $70,121 for share–based payments and $12,918 for depletion and accretion expenses.
8) Net income during this period includes non-cash deductions of $75,549 for share–based payments and $5,506 for depletion and accretion expenses.
9) 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.
10) 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.
11) The Company reclassified costs associated with Cutlass to assets held for sale

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 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 January 31, 2014, the Company had working capital of $22,052,555 (January 31, 2013 - $2,479,404), which is substantially comprised of cash of $11,097,174, accounts receivable of $1,939,538 and oil & gas assets held for resale with a carrying value of approximately $10 million (see Note 4 in the consolidated financial statements) less current liabilities of $1,119,518 due within three months of January 31, 2014.

It is Management's intention to dispose of the oil and gas assets held for resale in due course and use the proceeds from the sale to further develop the Company's core assets.

As at January 31, 2014 and the date of this report, the Company had outstanding long term convertible notes in the principal amount of CAD $38,825,000 and CAD $38,750,000, respectively (January 31, 2013 - $nil), which are due on April 2, 2018. These notes bear interest calculated at 8% per annum, which is payable quarterly, and may become immediately due in the event of default. A more detailed description of the notes is set out in Note 9 to the Company's consolidated financial statements for the year ended January 31, 2014.

Subsequent to January 31, 2014, the Company issued 850,000 common shares for proceeds of CAD $153,000 upon the exercise of warrants at an exercise price of CAD $0.18 per share.

The Company's working capital will be used to fund the development of the Company's oil and gas properties (see commitments described under "Exploration and Evaluation") and for general working capital purposes.

As of the date of this report, the Company has no significant commitments or restrictions on its cash except as described herein (see “Exploration and Evaluation”) and in the Company’s consolidated financial statements for the year ended January 31, 2014. The Company has not pledged any of its assets as security for loans, or otherwise, and is not subject to any material debt or other covenants.

Management of the Company believes it has or will generate from operations or the sale of assets held for resale sufficient capital to meet its existing financial obligations over the next twelve months. However, there is no assurance the Company will generate sufficient sustainable cash flows to fund the future development of its oil and gas properties as presently planned and therefore the Company may have to seek additional financing (see commitments described under “Exploration and Evaluation Assets”). Although the Company has been successful with securing capital in the past, there is no assurance that it will secure necessary capital in the future.

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:

	2014	2013
Short-term compensation		
CEO	$ 495,000	$ 293,175
CFO	43,168	34,768
COO	92,500	-
VP Exploration	100,000	-
VP Geosciences	100,000	-
Secretary	72,253	62,922
Share-based payments	214,705	56,648
	$ 1,117,625	$ 447,513

As at January 31, 2014:

(a) accounts receivable include advances to key management personnel totalling $47,562 (2013 - $21,230) for expenses incurred by the Company on their behalf;
(b) accounts payable and accrued liabilities include amounts payable to key management personnel totalling $7,870 (2013 - $42,368); and
(c) convertible notes held by key management personnel and their close family members totalled CAD $3,090,000.

During the year, the Company:

(a) provided a bonus of $300,000 (2013 - $nil) to its Chief Executive Officer in respect of activities carried out in the Company's previous fiscal year. The Company issued 80,000 (2013 – nil) common shares with a fair value of $140,000 and made a cash payment in the amount of $160,000 to settle the bonus. The cash payment is included in short-term compensation and the value of the shares issued in share-based payments set out in the above table.

(b) paid or accrued legal fees and share issue costs totaling $nil (2013 - $56,013) to a law firm of which the former corporate secretary of the Company is a principal.

Proposed transactions

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

New Accounting Pronouncements

All of the new and revised standards described below may be early-adopted:

IFRS 9 Financial Instruments (2009)

IFRS 9 introduces new requirements for classifying and measuring financial assets, as follows:

- Debt instruments meeting both a "business model" test and a "cash flow characteristics" test are measured at amortized cost (the use of fair value is optional in some limited circumstances)
- Investments in equity instruments can be designated as "fair value through other comprehensive income" with only dividends being recognized in profit or loss
- All other instruments (including all derivatives) are measured at fair value with changes recognized in profit or loss
- The concept of "embedded derivatives" does not apply to financial assets within the scope of the standard and the entire instrument must be classified and measured in accordance with the above guidelines.

The IASB has indefinitely postponed the mandatory adoption date of this standard.

IFRS 9 Financial Instruments (2010)

This is a revised version incorporating revised requirements for the classification and measurement of financial liabilities, and carrying over the existing de-recognition requirements from IAS 39 *Financial Instruments: Recognition and Measurement*.

The revised financial liability provisions maintain the existing amortized cost measurement basis for most liabilities. New requirements apply where an entity chooses to measure a liability at fair value through profit or loss; in these cases, the portion of the change in fair value related to changes in the entity's own credit risk is presented in other comprehensive income rather than within profit or loss.

The IASB has indefinitely postponed the mandatory adoption date of this standard.

Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)

Amends IAS 36 *Impairment of Assets* to reduce the circumstances in which the recoverable amount of assets or cash-generating units is required to be disclosed, clarify the disclosures required, and to introduce an explicit requirement to disclose the discount rate used in determining impairment (or reversals) where recoverable amount (based on fair value less costs of disposal) is determined using a present value technique.

Applicable to annual periods beginning on or after January 1, 2014.

The following accounting policies were adopted during the year ended January 31, 2014:

Investment in partnership

The Company accounts for its investment in partnership using the equity method. Under the equity method, the investment is initially recorded at cost and the carrying value is adjusted thereafter, to reflect the Company's pro-rata share of income or loss of the equity accounted investment. The Company's share of net income or loss is included in the consolidated statements of operations and comprehensive loss as equity income in partnership.

Convertible notes

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

Assets held for sale

Non-current assets, or disposal groups consisting of assets and liabilities, are classified as held-for-sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable and the asset is available for immediate sale in its present condition.

Non-current assets classified as held-for-sale are measured at the lower of the carrying amount and fair value less costs of disposal, with impairments recognized in profit or loss in the period measured. Non-current assets and disposal groups held-for-sale are presented in current assets and liabilities within the consolidated statements of financial position. Assets held-for-sale are not depreciated, depleted or amortized.

Critical accounting estimates

The preparation of 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.

Reserves

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

Carrying value of property and equipment and exploration and evaluation assets

The Company assesses at each reporting date whether there is an indication that an asset or cash-generating unit ("CGU") may be impaired. A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of cash inflows of other assets or groups of assets. The allocation of assets into CGUs requires significant judgment and interpretation with respect to the way in which management monitors operations. If any indication exists that an asset or CGU may be impaired, the Company estimates the recoverable amount. The recoverable amounts of individual assets and CGUs have been determined based on the higher of value-in-use calculations and fair value less costs to sell. These calculations require the use of estimates and assumptions, such as estimates of proved plus probable reserves, future production rates, oil and natural gas prices, future costs and other relevant assumptions, all of which are subject to change.

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

Assets held for sale

Judgment is required in determining whether an asset meets the criteria for classification as "assets held for sale" in the consolidated statements of financial position. Criteria considered by management include the existence of and commitment to a plan to dispose of the assets, the expected selling price of the assets, and the expected timeframe of the completion of the anticipated sale. Additionally, there is a requirement to recognize the assets held for sale at the lower of their carrying value and fair value less costs to sell. Management has evaluated the expected fair value less costs to sell and determined that it is lower than the carrying value, based on initial expressions of interest from potential acquirers, and the value reported in a reserve report as of January 31, 2014. Based on these factors, assets held for sale have been remeasured at $10,000,000, being the lower of carrying value and fair value less costs to sell.

Depreciation and depletion

Depletion of oil and gas properties is provided using the unit-of-production method based on production volumes before royalties in relation to total estimated proved reserves as determined annually by independent engineers and internal reserve evaluations on a quarterly basis. Natural gas reserves and production are converted at the energy equivalent of approximately six thousand cubic feet to one barrel of oil.

Accounts receivable

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

Decommissioning obligations

Amounts recorded for decommissioning obligations require the use of management's best estimates of future decommissioning expenditures, expected timing of expenditures and future inflation rates. The estimates are based on internal and third party information and calculations are subject to change over time and may have a material impact on profit and loss or financial position.

Share-based payments

The fair value of share-based payments is subject to the limitations of the Black-Scholes option pricing model that incorporates market data and involves uncertainty in estimates used by management in the assumptions. Because the Black-Scholes option pricing model requires the input of highly subjective assumptions, including the volatility of share prices, changes in subjective input assumptions can materially affect the fair value estimate.

Risk Factors

The exploration and development of oil and gas properties involves certain significant risks not within the control of management. Risks factors affecting the prospects of the Company include, but are not limited to, the following:

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 & 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 therefrom 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.

Additional Funding Requirements

Terrace has limited history of production or profitability and its financial resources may not be sufficient to fund its ongoing activities at all times (see commitments described under "Exploration and Evaluation"). From time to time, the Company will require additional financing to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing 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.

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 exploration and quarrying, 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.

Reserve Estimates

No current reserves have been estimated in respect of the Company's oil & gas properties. 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.

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. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may 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. 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.

Lack of Adequate Insurance

In the course of exploration, development and production of mineral 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.

Risks Associated with Joint Operating Agreements

The development of the Company's oil & gas properties is governed by a various joint operating agreements. The existence or occurrence of a disagreement or dispute with or among the other parties to such agreement could have a material adverse impact on the Company's profitability or the viability of its interests, which could have a material adverse impact on the Company's business prospects, results of operations and financial condition.

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 provincial 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 the Properties 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.

Current Global Financial Conditions

Current global financial conditions have been subject to increased volatility and numerous financial institutions have either gone into bankruptcy or have had to be rescued by governmental authorities. Access to public financing has been negatively impacted by both sub-prime mortgages and the liquidity crisis affecting the asset-backed commercial paper market. These factors may impact the ability of the Company to obtain equity or debt financing in the future and, if obtained, on terms favourable to the Company. If these increased levels of volatility and market turmoil continue, the Company's operations could be adversely impacted and the value and the price of the Company's shares could continue to be adversely affected.

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. In addition, the pro-rationing of capacity on the inter-state pipeline systems also continues to affect the ability to export oil and natural gas.

Reliance on Key Individuals

The Company's success depends to a certain degree upon certain key members of the management. 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 the 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, liabilities associated with assets held-for-sale and convertible notes – as other financial liabilities.

The Company's risk exposure and the impact on the Company's financial instruments are summarized below:

Fair value

The carrying values of 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 financing is raised in CAD, but a portion of the Company's operations is conducted in USD. Therefore, the Company is impacted by changes in the exchange rate between the Canadian and US dollars.

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

	2014 (USD)	**2013 (USD)**
Cash	$ 8,595,184	$ 1,502,509
Accounts receivable	1,856,863	1,302,356
Operators bond	25,000	25,000
Accounts payable and accrued liabilities	(223,073)	(483,690)
Liabilities associated with assets held for sale	(56,151)	-
Net	$ 10,197,823	$ 2,346,175
Canadian dollar equivalent	CAD $ 11,358,335	CAD $ 2,344,399

Based on the above net exposures as at January 31, 2014, a 5% change in the Canadian/US exchange rate would impact the Company's net loss and comprehensive loss by approximately $568,000 (2013 - $117,000).

(iii) Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in the market prices, other than those arising from interest rate risk or foreign currency risk. The Company is not exposed to significant other price risk.

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in satisfying financial obligations as they become due. The Company manages liquidity risk through maintaining sufficient cash on hand to meet its obligations as they become due. As at January 31, 2014, the Company had cash of $11,097,174, accounts receivable of $1,939,538, current liabilities of $1,119,518 and convertible notes totaling CAD $39,280,000 on maturity. The current liabilities are due within three months of year-end and the convertible notes mature April 2, 2018.

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

As at January 31, 2014 and the date of this report, the Company had outstanding long term convertible notes in the principal amount of CAD $38,825,000 and CAD $38,750,000, respectively (January 31, 2013 - $nil), which are due on April 2, 2018.

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

Shareholder's Equity and Outstanding Share Data

The authorized share capital of the Company consists of an unlimited number of common shares. As of January 31, 2014 the Company had 74,434,321 common shares outstanding. As of the date of this report, there were 75,321,821 common shares outstanding.

Subsequent to January 31, 2014, the Company issued:

a) 37,500 common shares on the conversion of CAD $75,000 convertible notes; and

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

As of the date of this report, the Company had the following stock options and warrants outstanding:

- Stock options

Number of Options	Number of Options Exercisable	Exercise Price (CAD)	Expiry Date	Weighted Average Remaining Contractual Life (Years)
1,650,000	1,650,000	$ 0.12	June 22, 2016	2.39
250,000	212,500	$ 0.19	July 15, 2016	2.45
250,000	175,000	$ 0.21	September 16, 2016	2.60
250,000	175,000	$ 0.19	October 18, 2016	2.72
100,000	100,000	$ 0.53	November 25, 2016	2.82
250,000	175,000	$ 0.67	December 16, 2016	2.87
150,000	82,500	$ 1.35	July 8, 2017	3.44
2,900,000	2,570,000			2.54

- Warrants

	Number of Warrants	Weighted Average Exercise Price (CAD)	Expiry Date
Balance - January 31, 2014	1,350,000	$ 0.18	June 21, 2016

Restricted Share Units

The Corporation had no restricted share units ("RSUs") outstanding as of January 31, 2013. On October 21, 2013, the Corporation issued 950,000 RSUs with a value of CAD $2,470,000 and subsequent to the year ended January 31, 2014 granted an additional 100,000 RSU's to a new employee of the Company. Each RSU, upon vesting, gives the holder the right to receive one Common Share. Unless otherwise approved by the Corporation'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 Corporation's board of directors, unvested RSUs will expire five years from the date of grant. Vested RSUs will be settled, at the election of the Corporation, 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, 2014 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
George Morris	Chief Operating Officer
Scott Davis	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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