

TERRACE ENERGY CORP.
(the “Company” or “Terrace”)
MANAGEMENT’S DISCUSSION AND ANALYSIS
OF THE COMPANY’S FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE THREE MONTHS ENDED APRIL 30, 2013 AND 2012

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 June 27, 2013 and should be read in conjunction with the unaudited condensed consolidated financial statements for the three months ended April 30, 2013 and 2012 and the related notes contained therein which have been prepared under International Financial Reporting Standards (“IFRS”), the audited consolidated financial statements and the related MD&A for the year ended January 31, 2013, and all other disclosure documents of the Company. The information contained herein is not a substitute for detailed investigation or analysis on any particular issue. The information provided in 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.

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 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 financial statements do not conform with, nor are they reconciled to, accounting principles generally accepted in the United States.

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Overview

Terrace Energy Corp. was incorporated on July 6, 2006 under the Business Corporations Act (British Columbia) and previously named Terrace Resources Inc.

The Company is classified as a Tier 2 Oil and Gas issuer. Its common shares trade on the Exchange under the symbol "TZR".

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.

All dollar amounts are in United States dollars unless specifically noted otherwise.

The Company's head office is located at Suite 270, 666 Burrard Street, Vancouver, British Columbia V6C 2X8. 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 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:

<u>Name of subsidiary</u>	<u>Place of Incorporation</u>	<u>Percentage ownership</u>
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%

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 acres (3,875 net acres) in LaSalle and McMullen Counties, Texas and an evaluation well. The aggregate purchase price was \$1,001,269.

The Company's share of the aggregate costs, during the year, to drill, complete and place into production three wells was \$6,760,921, which is set out in more detail below. These costs and \$60,000 of the acreage lease acquisition cost were transferred from Exploration and Evaluation assets to Property and Equipment.

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Well	Working Interest	Net Revenue Interest	Production Date	Number of Days in Production to April 30, 2013	Cost	Cumulative Revenues
STS 1-667	16.87%	12.65%	February 10, 2012	445	\$ 1,564,943	\$ 1,039,670
SP5 #1-47H	33.00%	25.00%	October 18, 2012	194	2,634,631	1,716,556
SP5 #2-47H	33.00%	25.00%	October 20, 2012	192	2,561,347	1,484,245
Miscellaneous					-	30,644
					<u>\$ 6,760,921</u>	<u>\$ 4,271,115</u>

Net sale of hydrocarbon production from these three wells from their completion to April 2013 totaled 37,205 barrels of oil, 68,094 mcf gas and 558,772 gallons of natural gas liquids or 61,859 BOEPD. The Company has secured its working and net revenue interests in all of the project acreage subject to participation in the development of additional wells proposed from time to time by the project's operator. The Company and the operator have formulated a project development plan for 2013 that includes drilling six additional horizontal development wells. The first well in this program was spud on March 31, 2013.

Cutlass

In November 2011, the Company entered into an agreement, through a wholly-owned subsidiary, to earn a 25% working interest and an 18.75% net revenue interest in certain leases covering 3,395 net acres in Dimmit and LaSalle counties, Texas for \$367,666 and a commitment to participate in a two well drilling program. In February 2012, the Company acquired an additional 5% working interest and 3.75% net revenue interest for an additional \$234,097.

In order to earn the net revenue interests (22.5% in aggregate), the Company agreed to pay 33.33% of all costs, including acreage leases, prospect fees, site preparation and drilling, until the completion of two wells, and thereafter 30% of all costs relating to the lease payments, prospect fees and infrastructure costs covering 1,342 net acres (the "Dimmit County Acreage").

Drilling of the first well (the Cutlass West #A-1H) on the Dimmit County acreage was substantially completed in June, 2012. The results were subsequently analyzed and the well fracture stimulated on March 28, 2013 of which the results are forthcoming. The Company's share of well and infrastructure costs to April 30, 2013 was \$3,425,191. The treatment was successful and flowback testing began on April 24, 2013. Facility construction is complete and pipeline construction operations are underway. The Company expects the well to be placed into production in the second quarter of 2013 at an additional estimated cost of \$1,000,000.

The Company must participate in the development of a second well on the Dimmit County Acreage at an estimated cost of \$1,190,333. Drilling on this well (the Cutlass West #B-2H) commenced on May 19, 2013. If successful, completion operations will be scheduled for later in 2013.

After the drilling and technical evaluation of the first well on the Dimmit County Acreage, the Company exercised its option to earn a 22.5% net revenue interest in the remaining 2,053 acres (the "LaSalle County Acreage") at a cost of \$570,462. The Company was obligated to fund 30.00% of the cost of an initial vertical evaluation well and 33.33% of an initial horizontal well on the La Salle County acreage.

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The initial obligation well on the LaSalle County Acreage (the Cutlass East A-1 well) was substantially completed on August 11, 2012 with the wellbore suspended as a planned vertical monitor well. Further deepening or completion alternatives will be determined later in the year pending results of additional drilling on the acreage. The Company's share of well and infrastructure costs to April 30, 2013 was \$1,928,723. A second well (the Cutlass East #B-2H) was spudded on April 26, 2013. Drilling operations were successfully completed on May 16, 2013 at an estimated cost to the Company of \$1,214,332. Completion operations are scheduled for later in 2013.

As April 30, 2013, the Company had advanced the aggregate sum of \$4,182,071 to the project operator representing its share of estimated costs of the ongoing activities described above.

BlackBrush Terrace LP

The Company entered into an agreement with BlackBrush Oil & Gas, LP ("BlackBrush") to organize a special purpose limited partnership, the BlackBrush Terrace LP (the "SPLP"), to acquire a 50% working interest in certain oil and gas leases in Maverick County south Texas, USA (the "WI") from SWEPI LP ("Shell Oil").

The Company and BlackBrush have agreed that each party must fund its 50% share of the costs to drill and complete four Pearsall horizontal wells and one Eagle Ford horizontal well (the "Obligation Wells") or forfeit their respective interest in the SPLP and each party's interest in the SPLP may be adjusted, in defined circumstances, where one party finances a disproportionate share of costs to drill and complete additional wells.

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

1. the SPLP 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 incurred in connection with the drilling and completion of the Obligation Wells;
6. upon making the Carry Payment in full, the SPLP will pay 50% of all development costs for the right to participate in a 50% working interest in each subsequent 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 is made in full or (ii) establishment of production from a given

At April 30, 2013, the Company advanced the aggregate sum of \$12,915,830 representing its share of costs to organize, acquire and fund certain agreed upon exploration and evaluation activities to-date.

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Results of Operations

For the three months ended April 30, 2013 and 2012

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 three months ended April 30, 2013 was \$537,828 compared to net income of \$212,753 for the three months ended April 30, 2012. The results are summarized as follows:

	2013	2012
Oil & Gas revenues	\$ 856,011	\$ 557,090
Direct operating expenses	188,329	65,443
Depreciation, depletion and accretion	272,758	5,519
	461,087	70,962
	394,924	486,128
General and administrative expenses	522,505	228,688
Interest Expense	199,187	-
Foreign exchange loss (gain)	33,793	(31,043)
Share-based payments	73,117	75,730
Impairment of exploration and evaluation assets	104,150	-
	932,752	273,375
Net (loss) income for the period	\$ (537,828)	\$ 212,753

Oil and gas sales for the three months ended April 30, 2013 were \$856,011 compared to \$557,090 for the three months ended April 30, 2012.

The Company's first well was completed and placed into production in February, 2012. Its second and third wells were placed into production in late October 2012. The Company's aggregate share of production from these wells for the three months ended April 30, 2013 was approximately 11,468 barrels of oil and liquids at an average price of \$98.49 per barrel and 17,921 million cubic feet of natural gas at an average price of \$3.35 per million cubic feet.

Direct operating expenses inclusive of royalties was \$188,329 for the three months ended April 30, 2013 compared to \$65,443 for the three months ended April 30, 2012, net of depreciation, depletion and accretion expenses of \$272,758 and \$5,519 respectively.

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General and Administrative expenses for the three months ended April 30, 2013 were \$522,505 compared to \$228,688 for the three months ended April 30, 2012. The increase in these expenses is primarily attributable to an increase in office costs, executive and other salaries, rent, professional fees, transfer agent and Exchange fees and investor relations costs due to growing the business and increased activity during the period. The previous year's amount is also net of a recovery of previously disputed sales tax in the amount of \$41,680.

Interest expense for the three months ended April 30, 2013 were \$199,187 compared to \$nil for the three months ended April 30, 2012 which is primarily attributable to the convertible notes the Company completed during the current period.

Summary of Quarterly Results

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

	April 30, 2013	January 31, 2013	October 31, 2012	July 31, 2012
Revenue ¹	\$ 856,011	\$ 2,322,331	\$ 332,815	\$ 202,868
Net (loss) income	(537,828)	106,951 ²	(200,670) ³	(240,756) ⁴
Exploration and evaluation	8,757,149	6,737,039	6,370,695	7,974,638 ⁶
Property and equipment	5,810,585	6,047,528	7,155,849 ⁷	1,471,266
Total assets	39,699,459	16,319,564	15,734,818	15,831,189
(Loss) income per share – basic and diluted	(0.01)	0.00	(0.00)	(0.00)

	April 30, 2012	January 31, 2012,	October 31, 2011	July 31, 2011
Revenue ¹	\$ 557,090	\$ -	\$ -	\$ -
Net income (loss)	212,753 ⁵	(587,960) ⁸	(262,969) ⁹	(262,715) ¹⁰
Exploration and evaluation	3,224,976	1,754,821	364,959	-
Property and equipment	1,316,761	-	-	-
Total assets	9,471,838	5,553,285	3,362,630	3,456,588
Income (loss) per share – basic and diluted	0.00	(0.01)	(0.00)	(0.00)

Notes:

- 1) All revenues during these periods are a result of a net sale of hydrocarbon production from the three STS Olmos wells
- 2) Net income during this period includes non-cash deductions of \$142,042 for share-based payments, \$94,879 for depletion and accretion expenses
- 3) 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
- 4) Net loss during this period includes non-cash deductions of \$70,121 for share-based payments and \$12,918 for depletion and accretion expenses.
- 5) Net income during this period includes non-cash deductions of \$75,549 for share-based payments and \$5,506 for depletion and accretion expenses.
- 6) During this period, the Company completed its share of the costs to drill, evaluate and case the two wells related to the STS Olmos project and completed drilling of the first well related to the Dimmit County Acreage.
- 7) During this period, the Company transferred \$6,820,921 from exploration and evaluation assets to property and equipment related to the three STS Olmos wells

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- 8) The Company's loss during this period includes non-cash deductions of \$95,878 for share-based payments and \$234,564 for impairment of oil and gas properties.
- 9) The Company's loss includes expenses incurred in connection with the Company's new business after the completion of its qualifying transaction in June 2011.
- 10) The Company's loss during this period includes non-cash deductions of \$173,699 for share-based payments.

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. There was no impact on quarterly results transitioning from Canadian Generally Accepted Accounting Principles to International Financial Reporting Standards ("IFRS").

Financial Condition, Liquidity and Capital Resources

As at April 30, 2013, the Company had cash of \$7,291,039, accounts receivable of \$550,239 and accounts payable and accrued liabilities of \$757,959 due within three months of the three months ended April 30, 2013.

Subsequent to April 30, 2013 the Company completed additional non-brokered private placements of convertible, unsecured promissory notes in the aggregate principal amount of CAD\$15,000,000 on substantially the same terms and conditions of the convertible notes issued in the previous period.

Including the private placement completed subsequent to April 30, 2013, the Company has long term convertible notes in the aggregate principal amount of CAD \$40,000,000, 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 8 to the Company's unaudited condensed consolidated interim financial statements for the three months ended April 30, 2013.

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 unaudited consolidated interim financial statements for the three months ended April 30, 2013. The Company has not pledged any of its assets as security for loans, or otherwise, and is not subject to any debt or other covenants. Management of the Company believes it has or will generate from operations sufficient capital to meet its 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 and therefore 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.

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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:

	2013	2012
Short-term compensation	\$ 98,321	\$ 54,400
Share-based payments	11,508	10,913
	\$ 109,829	\$ 65,313

As at April 30, 2013:

- (a) Included in accounts payable and accrued liabilities are amounts payable to key management personnel totalling \$Nil (January 31, 2013 - \$42,368).

New accounting standards and interpretation

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2013, including IAS 19 *Employee Benefits*, IAS 27 *Separate Financial Statements*, IAS 28 *Investments in Associates and Joint Ventures*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interest of Other Entities*, and IFRS 13 *Fair Value Measurement*. The Company has adopted these policies and none of them have a significant effect on the condensed interim consolidated financial statements.

IFRS 9 *Financial Instruments* is effective for annual periods beginning after January 1, 2015. The extent of the effects of this new accounting standard on the condensed interim consolidated financial statements has not been determined.

Convertible notes

The liability component of convertible debentures 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 debenture is measured at amortized cost using the effective interest method. The equity component is not re-measured subsequent to initial recognition

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 – as other financial liabilities.

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

Fair value

The carrying values of cash, accounts receivable, and accounts payable and accrued liabilities approximate their fair values due to the short-term maturity of these financial instruments. The fair value of the operators bond also approximates its carrying value.

Credit risk

Credit risk is the risk of potential loss to the Company if the counterparty to a financial instrument fails to meet its contractual obligations.

The Company's credit risk is primarily attributable to its cash and accounts receivable. The credit risk associated with cash is mitigated since the cash is held at major financial institutions with high credit ratings. Accounts receivable consists primarily of trade receivables outstanding from operators of its oil and gas interests. To mitigate this risk, the Company regularly reviews the collectability of accounts receivable to ensure there is no indication that these amounts will not be fully recoverable.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in the market prices. Market risk is comprised of three types of risk: interest rate risk, foreign currency risk and other price risk.

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(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:

	April 30, 2013	January 31, 2013
	(USD)	(USD)
Cash	\$ 4,127,363	\$ 1,502,509
Accounts receivable	1,803,538	1,302,356
Operators bond	25,000	25,000
Accounts payable and accrued liabilities	(529,450)	(483,690)
Net	\$ 5,426,451	\$ 2,346,275
Canadian dollar equivalent	CAD\$ 5,465,521	CAD\$ 2,344,399

Based on the above net exposures as at April 30, 2013, a 5% change in the Canadian/US exchange rate would impact the Company's net loss and comprehensive loss by approximately \$271,300.

(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 April 30, 2013, the Company had cash of \$7,291,039 accounts receivable of \$550,239, prepaid expenses of \$167,546 and accounts payable and accrued liabilities of \$757,959 due within three months of year-end.

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Subsequent to April 30, 2013 the Company completed an additional private placement of convertible, unsecured promissory notes in the aggregate principal amount of CAD \$15,000,000 on substantially the same terms and conditions of the convertible notes issued in the previously period.

Including the private placement completed subsequent to April 30, 2013, the Company has long term convertible notes in the aggregate principal amount of CAD \$40,000,000, which are due on April 2, 2018. These notes bear interest calculated at 8% per annum, which is payable quarterly. The notes may become immediately due in the event of default. A more detailed description of the notes is set out in Note 8 to the Company's unaudited consolidated interim financial statements for the three months ended April 30, 2013

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.

Shareholder's Equity and Outstanding Share Data

The authorized share capital of the Company consists of an unlimited number of common shares. As of April 30, 2013 and the date of this report, the Company had 63,069,321 common shares outstanding.

As of the date of this report, the Company had issued and outstanding notes in the aggregate principal amount of CAD \$25,000,000 convertible into 12,500,000 common shares of the Company.

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
1,650,000	1,650,000	\$ 0.12	June 22, 2016
250,000	137,500	\$ 0.19	July 15, 2016
250,000	100,000	\$ 0.21	September 16, 2016
250,000	100,000	\$ 0.19	October 18, 2016
100,000	60,000	\$ 0.53	November 25, 2016
250,000	100,000	\$ 0.67	December 16, 2016
150,000	37,500	\$ 1.35	July 8, 2017
2,900,000	2,185,000		

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• Warrants

	Number of Warrants	Weighted Average Exercise Price (CAD)	Expiry Date
Balance - January 31, 2012, 2013 and April 30, 2013	7,112,500	\$ 0.18	June 21, 2016

Reserves Data and Other Oil and Gas Information

Our independently prepared reserves assessment and evaluation of oil and gas properties effective February 1, 2013 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 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 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.

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Directors and Officers

Eric Boehnke	Director and CEO
David Gibbs	Director and President
Dan Carriere	Director and Non-Executive Chairman
Murray Oliver	Director
William McCartney	Director
Ken Shannon	Director
Scott Davis	CFO
Deborah Cotter	Secretary

Contact Person

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