TERRACE ENERGY CORP.
CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in United States Dollars)

JANUARY 31, 2018 AND 2017

Smythe CPA

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF TERRACE ENERGY CORP.

We have audited the accompanying consolidated financial statements of Terrace Energy Corp., which comprise the consolidated statements of financial position as at January 31, 2018 and 2017 and the consolidated statements of operations and comprehensive income (loss), changes in shareholders' deficit and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility
Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Terrace Energy Corp. as at January 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board.

Emphasis of Matter
Without modifying our opinion, we draw attention to note 1 in the consolidated financial statements, which describes matters and conditions that indicate the existence of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern.

Smythe LLP

Chartered Professional Accountants

Vancouver, British Columbia
May 29, 2018

Vancouver
7th Floor 355 Burrard St
Vancouver, BC V6C 2G8
T: 604 687 1231
F: 604 688 4675

Langley
305 – 9440 202 St
Langley, BC V1M 4A6
T: 604 282 3600
F: 604 357 1376

Nanaimo
201 – 1825 Bowen Rd
Nanaimo, BC V9S 1H1
T: 250 755 2111
F: 250 984 0886

Smythe LLP | **smythecpa.com**

TERRACE ENERGY CORP.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
As at January 31
(Expressed in United States Dollars)

	2018	2017
ASSETS		
Current assets		
Cash	$ 1,421,810	$ 2,532,786
Accounts receivable	17,281	22,014
Prepaids	62,010	96,243
Assets held for sale (Note 5)	4,826,382	-
Total current assets	6,327,483	2,651,043
Non-current assets		
Operator’s bond	-	25,000
Investment in partnership (Note 5)	-	5,105,697
Property and equipment (Note 7)	19,126	49,264
Total assets	$ 6,346,609	$ 7,831,004
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities		
Accounts payable and accrued liabilities (Note 14)	$ 630,868	$ 652,323
Total current liabilities	630,868	652,323
Non-current liabilities		
Convertible notes (Notes 9 and 15)	17,328,649	13,382,619
Total liabilities	17,959,517	14,034,942
Shareholders' deficit		
Capital stock (Note 10)	47,689,739	47,689,739
Convertible notes – equity component (Note 9)	2,003,196	2,003,196
Stock options reserve (Note 10)	-	153,375
Translation reserve	(1,645,699)	265,447
Deficit	(59,660,144)	(56,315,695)
Total shareholders’ deficit	(11,612,908)	(6,203,938)
Total liabilities and shareholders’ deficit	$ 6,346,609	$ 7,831,004

Approved on behalf of the Board:

“William Gibbs”	“William McCartney”
William Gibbs, CEO & Director	William McCartney, Director

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

TERRACE ENERGY CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
For the years ended January 31
(Expressed in United States Dollars)

		2018		2017
GENERAL AND ADMINISTRATIVE EXPENSES				
Administrative		448,454		481,074
Depreciation (Note 7)		35,082		56,884
Investor relations		-		15,169
Professional		91,046		427,786
Salaries and benefits (Note 15)		509,745		189,228
Transfer agent and filing fees		28,159		84,984
Travel		33,704		7,559
		(1,146,190)		(1,262,684)
Other Items				
Financing (Note 11)		(2,991,233)		(2,651,933)
Foreign exchange gain		918,914		3,028,397
Provision for litigation (Note 14)		-		(500,000)
Gain on note extinguishment (Note 9)		-		15,264,839
Loss on disposition of investment (Note 4)		-		(1,090,509)
Net income (loss) from continuing operations for the year		(3,218,509)		12,788,110
Net loss from discontinued operations for the year (Notes 4 and 5)		(279,315)		(9,340,041)
Net income (loss) for the year		(3,497,824)		3,448,069
Other comprehensive loss				
Translation adjustment		(1,911,146)		(4,197,536)
Recycle of translation differences on disposal of subsidiaries		-		5,147,557
Comprehensive income (loss) for the year	$	(5,408,970)	$	4,398,090
Basic and diluted earnings (loss) per share – Continuing (Note 18)	$	(0.04)	$	0.15
Basic and diluted loss per share – Discontinued (Note 18)	$	(0.00)	$	(0.11)
Weighted average number of common shares outstanding, basic and diluted		88,484,821		88,057,321

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

TERRACE ENERGY CORP.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' DEFICIT
(Expressed in United States Dollars)

	Capital Stock		Convertible Notes – Equity Component	Stock Options Reserve	Warrants Reserve	Translation Reserve	Deficit	Total Shareholders' Deficit
	Shares	**Amount**						
Balance – January 31, 2016	**87,844,821**	**$ 47,416,203**	**$ 2,814,173**	**$ 1,034,242**	**$ 6,099**	**$ (684,574)**	**$(62,880,745)**	**$ (12,294,602)**
Expiry of options	-	-	-	(880,867)	-	-	880,867	-
Expiry of warrants	-	-	-	-	(6,099)	-	6,099	-
Restructure of convertible notes	-	-	(785,003)	-	-	-	2,230,015	1,445,012
Conversion of convertible notes	650,000	273,536	(25,974)	-	-	-	-	247,562
Cumulative translation adjustment	-	-	-	-	-	(4,197,536)	-	(4,197,536)
Recycle of translation differences	-	-	-	-	-	5,147,557	-	5,147,557
Net income for the year	-	-	-	-	-	-	3,448,069	3,448,069
Balance – January 31, 2017	**88,494,821**	**$ 47,689,739**	**$ 2,003,196**	**$ 153,375**	**$ -**	**$ 265,447**	**$(56,315,695)**	**$ (6,203,938)**
Expiry of stock option reserve	-	-	-	(153,375)	-	-	153,375	-
Cumulative translation adjustment	-	-	-	-	-	(1,911,146)	-	(1,911,146)
Net loss for the year	-	-	-	-	-	-	(3,497,824)	(3,497,824)
	-							
Balance – January 31, 2018	**88,494,821**	**$47,489,739**	**$ 2,003,196**	**$ -**	**$ -**	**$(1,645,699)**	**$(59,660,144)**	**$ (11,612,908)**

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

TERRACE ENERGY CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended January 31
(Expressed in United States Dollars)

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss) from continuing operations	$ (3,218,509)	$ 12,788,110
Items not involving cash:		
Accretion of convertible notes	2,991,233	2,009,301
Depreciation	35,082	56,884
Unrealized gain on foreign exchange	(962,653)	(2,633,832)
Gain on note extinguishment	-	(15,264,839)
Non-cash interest	-	642,632
Loss on disposition of investment	-	1,090,509
Changes in non-cash working capital items:		
Accounts receivable	4,733	47,904
Prepaids	34,233	(37,803)
Accounts payable and accrued liabilities	(21,455)	926,569
Operating cash flows from continuing operations	(1,137,336)	(374,565)
Operating cash flows from discontinued operations (Note 4)	-	(1,691,296)
Net cash used in operating activities	(1,137,336)	(2,065,861)
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash received on disposition of investment	-	223,438
Operator's bond	25,000	-
Investment in partnership	25,000	(39,278)
Investing cash flows from continuing operations	-	184,160
Investing cash flows from discontinued operations (Note 4)	-	796,971
Net cash provided by investing activities	-	981,131
CASH FLOWS FROM FINANCING ACTIVITIES		
Net cash used in financing activities from discontinued operations (Note 4)	-	(2,726,768)
Foreign exchange effect on cash	1,360	3,693
Change in cash for the year	(1,110,976)	(3,807,805)
Cash, beginning of the year	2,532,786	6,340,591
Cash, end of the year	$ 1,421,810	$ 2,532,786

Supplemental cash flow information (Note 17)

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

1. NATURE OF OPERATIONS AND GOING CONCERN

Terrace Energy Corp. (the "Company" or "Terrace") was incorporated on July 6, 2006 under the *Business Corporations Act* (British Columbia) and previously named Terrace Resources Inc. The Company is in the business of acquiring, exploring for and developing conventional onshore oil and gas properties in the United States.

The Company's head office is located at 25700 1-45-N, Suite 4067, The Woodlands. Texas, 77386. The registered and records office is located at Suite 1000 – 595 Howe Street, Vancouver, British Columbia, Canada V6C 2T5.

The Company had negative cash flow from its continuing operating activities for the year ended January 31, 2018 and has a limited history of production or profitability and its financial resources will not be sufficient to fund its debt obligations and ongoing activities beyond the near term (see Commitments described in Note 14). These conditions indicate the existence of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern. The Company will need to raise additional capital or seek other strategic alternatives to meet its debt obligations and to carry out its future oil and gas acquisition, exploration and development activities. There are no guarantees that the Company will be able to raise such additional capital when needed.

These consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. Management believes that the going concern assumption is appropriate for these consolidated financial statements since management continues to seek and evaluate strategic alternatives and financial options to enable the Company to meet its debt obligations and to carry out its future oil and gas acquisition, exploration and development activities. These consolidated financial statements do not include adjustments to amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue operations. Such adjustments could be material.

2. BASIS OF PRESENTATION

Statement of compliance

These consolidated financial statements, are prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

The Board of Directors approved the audited consolidated financial statements on May 29, 2018.

Basis of measurement

These consolidated financial statements have been prepared on a historical cost basis, except for certain financial instruments, which are measured at fair value. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

Functional and presentation currency

The functional currency of the Company is the Canadian dollar ("CAD"), as it is presently reliant upon the Canadian capital markets to fund its activities. The functional currencies of the Company's foreign subsidiaries are the CAD dollar. These consolidated financial statements are presented in the United States dollar ("USD"), as substantially all of the Company's assets and operations are situated in the USA. Assets and liabilities are translated into the presentation currency using the exchange rate in effect on the consolidated statement of financial position date, shareholders' deficit accounts are translated into the presentation currency using the historical exchange rate, and revenues and expenses are translated at the average rate for the period, which approximates the exchange rate in effect on the transaction date. Exchange gains and losses on translation are included as a separate component in shareholders' deficit as "translation reserve".

2. BASIS OF PRESENTATION (Continued)

Transactions denominated in foreign currencies are translated to the respective functional currencies of the Company's entities at exchange rates in effect at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate prevailing at that date.

Functional and presentation currency (Continued)

Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated to the functional currency at the exchange rate prevailing at the date of the transaction. Non-monetary items that are measured based on historical cost are translated using the exchange rate in effect at the date of the translation.

Foreign currency differences arising on translation are recognized in profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES

Use of judgments and 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.

Assets held for sale and discontinued operations

Judgment is required in determining whether an asset meets the criteria for classification as "assets held for sale" in the consolidated statements of financial position. Criteria considered by management include the existence of and commitment to a plan to dispose of the assets, the expected selling price of the assets, the expected timeframe of the completion of the anticipated sale and the period of time any amounts have been classified within assets held for sale. The Company reviews the criteria for assets held for sale each quarter and reclassifies such assets to or from this financial position category as appropriate. In addition, there is a requirement to periodically evaluate and record assets held for sale at the lower of their carrying value and fair value less costs to sell.

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

Joint arrangements

Judgment is required to determine when the Company has joint control over an arrangement, which requires an assessment of the relevant activities and when the decisions in relation to those activities require unanimous consent. Judgment is also required to classify a joint arrangement. Classifying the arrangement requires the Company to assess their rights and obligations arising from the arrangement including whether the arrangement is structured through a separate vehicle, in which case, judgment is also required to assess the rights and obligations arising from the legal form of the separate vehicle, terms of the contractual arrangement, and other relevant facts and circumstances. This assessment often requires significant judgment, and a different conclusion on joint control and whether the arrangement is a joint operation or a joint venture, may materially impact the accounting. Management has assessed the investment in partnership as a joint venture.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of judgments and estimates (Continued)

Convertible debenture

In accordance with the substance of the contractual arrangement, convertible debentures are compound financial instruments that are accounted for separately by their components: a financial liability and an equity instrument.

The identification of convertible debenture components is based on interpretations of the substance of the contractual arrangement and therefore requires judgment from management. The separation of the components affects the initial recognition of the convertible debenture at issuance and the subsequent recognition of interest on the liability component. The determination of the fair value of the liability is also based on a number of assumptions, including contractual future cash flows, discount factors, and the presence of any derivative financial instruments.

Modification verses extinguishment of convertible debenture

Judgment is required in applying IAS 39 *Financial Instruments: Recognition and Measurement* to determine whether the amended terms of the loan agreements are a substantial modification of an existing financial liability and whether it should be accounted for as an extinguishment of the original financial liability.

Functional currency

The determination of the functional currency for the Company and each of its subsidiaries was based on management's judgment of the underlying transactions, events and conditions relevant to each entity.

Going concern

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

Critical accounting estimates

Accounts receivable

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

Income taxes

Related assets and liabilities are recognized for the estimated tax consequences between amounts included in the consolidated financial statements and their tax basis using substantively enacted future income tax rates. Timing of future revenue streams and future capital spending changes can affect the timing of any temporary differences, and accordingly, affect the amount of the deferred tax asset or liability calculated at a point in time. These differences could materially impact earnings.

(Expressed in United States Dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Principles of consolidation

The consolidated financial statements include the financial statements of the Company and its controlled subsidiaries. All intercompany transactions, balances, revenues and expenses are eliminated in full on consolidation.

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

During the year ended January 31, 2017, the Company's ownership in Terrace STS, LLC ("Terrace STS") was reduced from 100% down to 5% (See Notes 4 and 8). As of May 20, 2016, Terrace STS was deconsolidated from the financial statements of the Company. Prior to that date, the results of operations, cash flows and financial position were consolidated within the financial statements of Terrace Energy Corp. Subsequent to May 20, 2016, Terrace STS was dissolved and the Company disposed of its 5% interest.

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

Financial instruments

All financial instruments are classified as one of the following: held-to-maturity, loans and receivables, fair value through profit or loss ("FVTPL"), available-for-sale or other financial liabilities. Financial assets and liabilities at FVTPL are measured at fair value with gains and losses recognized in profit or loss. Financial assets classified as held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method. Available-for-sale instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive loss and reported in shareholders' deficit.

Transaction costs that are directly attributable to the acquisition or issue of financial instruments that are classified as other than FVTPL, which are expensed as incurred, are included in the initial carrying value of such instruments.

Fair value hierarchy

Fair value measurements of financial instruments are required to be classified using a fair value hierarchy that reflects the significance of inputs in making the measurements. The levels of the fair value hierarchy are defined as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.
Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
Level 3 – Inputs for the asset or liability that are not based on observable market data.

Property and equipment assets

Depletion and depreciation

The calculation of depletion and depreciation of production equipment is based on total capitalized costs less the estimated net realizable value of production equipment and facilities after the proved developed reserves are fully depleted.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Depreciation of other equipment is provided for on a 14% to 20% straight-line basis. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

Impairment

Exploration and evaluation assets are grouped together with the Company's CGUs when they are assessed for impairment, both at the time of any triggering facts and circumstances, as well as upon their eventual reclassification to producing assets (oil and gas properties).

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of goodwill, if any, allocated to the units and then to reduce carrying amounts of other assets in the unit (group of units) on a pro rata basis.

Fair value less costs to sell is determined to be the amount for which the asset could be sold in an arm's length transaction. Fair value less costs to sell can be determined by using an observable market or by using discounted future net cash flows of proved and probable reserves using forecasted prices and costs. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset or CGU.

Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of accumulated depletion and depreciation or amortization, if no impairment loss had been recognized.

Investment in partnership

The Company considers the investment in the partnership a joint venture, and accordingly, accounts for its investment 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 income (loss) as equity income (loss) in partnership, on a stand alone basis or as a component of discontinued operations.

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 remeasured subsequent to initial recognition.

Income taxes

The Company uses the asset and liability method for accounting for income taxes. Under this method of tax allocation, deferred income tax assets and liabilities are determined based on differences between the financial statement carrying values and their respective income tax basis (temporary differences). Deferred income tax assets and liabilities are measured using the tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on deferred income tax assets and liabilities of a change in tax rates is included in the consolidated statement of operations in the year in which the change is enacted or substantively enacted. Deferred income tax assets are

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Capital stock

Proceeds from the issue of units is allocated between common shares and share purchase warrants on a relative fair value basis, based on the fair value of common shares being the market value on the date of announcement of the placement and the value of share purchase warrants, as determined using the Black-Scholes option pricing model.

Basic and diluted loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year. The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is calculated presuming the exercise of outstanding options, warrants and similar instruments.

It assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the year. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

Shares held in escrow, other than where their release is subject to the passage of time, are not included in the calculation of the weighted average number of common shares outstanding.

Share-based payments

The Company grants stock options to directors, officers, employees and consultants. Share-based payments to employees are measured on the grant date at the fair value of the equity instruments issued, using the Black-Scholes option pricing model and are accrued and charged to operations, over the vesting periods. Share-based payments to non-employees are measured at the fair value of the goods or services received or at the fair value of the equity instruments issued (if it is determined the fair value of the goods or services cannot be reliably measured), and are recorded at the date the goods or services are received. The offset to the recorded cost is to stock options reserve. Consideration paid for the shares on the exercise of stock options or warrants is credited to capital stock and the applicable amounts of stock options reserve are transferred to capital stock. Charges for options that are forfeited before vesting are reversed from stock options reserve and transferred to deficit. For options that expire or are forfeited after vesting, the recorded value is transferred from the stock options reserve to deficit.

Revenue recognition

Revenue from the sale of oil and gas is recorded when title passes to an external party and is based on volumes delivered to customers at contractual delivery points, and rates and collectability are reasonably assured. Delivery is generally at the time the product enters the pipeline. The costs associated with the delivery, including operating and maintenance costs, transportation and production based royalty expenses, are recognized during the same period in which the related revenue is earned and recorded.

Accounting standards that will become effective in future periods

The IASB or International Financial Reporting Interpretation Committee have issued pronouncements effective for accounting periods beginning on or after February 1, 2018. Only those that may significantly impact the Company are discussed below:

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Accounting standards that will become effective in future periods (continued)

IFRS 9 *Financial Instruments* (2014)

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

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

Applicable to the Company’s annual period beginning on February 1, 2018. The Company has not assessed the impact of this pronouncement.

IFRS 15 *Revenue from Contracts with Customers*

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

The five steps in the model are as follows:

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

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

Applicable to the Company’s annual period beginning on February 1, 2018. The Company has not assessed the impact of this pronouncement.

IFRS 16 *Leases*

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

Applicable to the Company’s annual period beginning February 1, 2019. The Company has not assessed the impact of this pronouncement.

4. DISPOSITION OF SUBSIDIARIES AND DISCONTINUED OPERATIONS

During the year ended January 31, 2017, the Company entered into a letter of intent with its secured lender whereby the lender to the Terrace STS entity agreed to convert its secured debt at the date of the transaction into 95% of the membership units of Terrace STS (see Note 8). On May 20, 2016, the Company completed the transaction to exchange the outstanding obligation owed to the lender into membership units of Terrace STS. Following the transaction, the Company continued to own the remaining 5% and operated Terrace STS pursuant to a management contract, as well as certain incentives.

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

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

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

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

The Company has determined that it is in its best interest to pursue divestiture of its partnership interest in Blackbrush Terrace LP (“BTLP”) (note 5). Consequently, the Company has classified its partnership interest in the BTLP as an Asset Held for Sale. The financial performance of the partnership for the current and comparative periods have been presented separately as discontinued operations in the consolidated statements of operations and comprehensive income (loss) and cash flows.

(Expressed in United States Dollars)

4. DISPOSITION OF SUBSIDIARIES AND DISCONTINUED OPERATIONS (Continued)

The reported net loss from the discontinued operations for the years ended January 31 is comprised of the following:

	2018	2017
Revenue		
Oil and gas sales	$ -	$ 409,560
Direct operating expenses		
Production and operating	-	602,954
Depreciation and depletion (Note 7)	-	837,821
Operating loss	-	(1,031,215)
Other expenses		
Financing (Note 11)	-	1,863,886
Salaries and benefits (Note 15)	-	112,349
	-	(1,976,235)
Loss on disposal of asset (Note 6)	-	(136,803)
Gain on disposition of Terrace STS	-	1,356,872
Equity loss (Note 5)	(279,315)	(2,405,103)
Net loss and disposal of subsidiaries and asset before recycling of foreign exchange	-	(4,192,484)
Recycling of foreign exchange	-	(5,147,557)
Net loss from discontinued operations, net of tax	$ (279,315)	$ (9,340,041)

The reported cash flows from the discontinued operations for the years ended January 31 are as follows:

	2018	**2017**
Net loss from discontinued operations	$ (279,315)	$ (9,340,041)
Depreciation and depletion	-	837,821
Accretion of decommissioning obligations	-	2,566
Non-cash interest expense	-	1,231,440
Gain on disposition of Terrace STS	-	(1,356,872)
Recycling of foreign exchange	-	5,147,557
Loss on disposal of asset	-	136,803
Equity loss	279,315	2,405,103
Changes in non-cash working capital items:		
Accounts payable and accrued liabilities	-	(755,673)
Operating cash flows from discontinued operations	$ -	$ (1,691,296)
Proceeds on disposal of asset	$ -	$ 1,300,000
Exploration and evaluation expenditures	-	(503,029)
Investing cash flows from discontinued operations	$ -	$ 796,971
Principal repayment of Credit Facility	$ -	$ (1,709,820)
Cash associated with disposition of Terrace STS	-	(1,016,948)
Net cash used in financing activities from discontinued operations	$ -	$ (2,726,768)

5. INVESTMENT IN PARTNERSHIP

The Company and its partner, BlackBrush Oil & Gas, LP ("BlackBrush") organized a special purpose limited partnership, the BlackBrush Terrace LP ("BTLP"), to acquire a 50% operated working interest (the "WI") in certain oil and gas leases covering approximately 147,000 gross mineral acres in Maverick County, Texas, USA (the "Maverick County Project") from SWEPI LP ("Shell Oil"). The acreage to be acquired includes potential reserves in the Eagle Ford Shale, Buda Limestone and several other intervals of Cretaceous age formations including the newly emerging Pearsall Shale Trend, which have been proven productive on a regional basis. The agreement allows BTLP to secure the WI through a combination of cash payments, which have been made, and drilling obligations. The material terms of the Farmout Agreement between the BTLP and Shell Oil are as follows:

1. the BTLP has made an up-front cash payment of $13 million;

2. the BTLP has the option, but not the obligation, to earn the assignment of the WI in all of the leases by spending an aggregate $104 million ($52 million net to Terrace), including $52 million ($26 million net to Terrace) representing Shell Oil's share of costs (the "Carry Payment") on certain qualified expenditures as development of the property progresses over time;

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

4. upon making the carry payment in full, the BTLP may request an assignment of 50% of Shell Oil's interest in all of the subject leases and should have the option, but not the obligation, to participate in a 50% working interest in each subsequent well by paying its proportionate share of all development costs for such well unless Shell Oil elects to convert its working interest in a producing formation into a net profits interest; and

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

In addition to the previously funded $13 million up-front payment, as of January 31, 2018, the BTLP has spent approximately $68 million towards its drilling obligation to Shell Oil. Under the terms of its agreement with Shell Oil, the BTLP is obligated to fund the remaining balance of the Carry Payment and drilling obligation (approximately $36 million) in 2018. If the Carry Payment is not satisfied in full by the end of 2018, then the BTLP will be required to pay $4 million in liquidated damages and the Farmout Agreement will be terminated. The BTLP and Shell Oil are in discussions to extend this obligation; however, there is no assurance that such an extension will be granted.

During the year ended January 31, 2016, the Company sought and came to an agreement with BlackBrush wherein to preserve capital, the Company would not contribute its share of costs to drill and complete additional wells. As a result, the Company's 50% ownership interest in the BTLP was reduced to approximately 39% at January 31, 2017 and further reduced to approximately 30% at January 31, 2018. In accordance with the provisions of the BTLP agreement, the Company is not entitled to any revenue and expense allocations or distribution of revenue proceeds from such additional wells.

The carrying value of $4,826,382 at January 31, 2018 (2017 - $5,105,697), which includes $24,483,125 in advances and capital contributions and represent the Company's share of costs to organize, acquire and fund certain agreed-upon exploration and evaluation activities to date plus the Company's share of the cumulative net loss of the BTLP of $19,656,743 (2017 - $19,377,428). Revenues and expenses attributable to the sole risk operations conducted by BlackBrush totaling a loss of $10,689,123 for the year ended January 31, 2018 (2017 - $117,602) are excluded from income and allocated to the partner before allocations of income to the partners in accordance with their ownership percentages. The Company's share of the BTLP loss recognized during the year ended January 31, 2018 was $279,315 (2017 - $2,405,103).

(Expressed in United States Dollars)

5. INVESTMENT IN PARTNERSHIP (Continued)

During the year ended January 31, 2018, management made the decision to sell its investment in BTLP, which is currently being marketed for sale (note 4). The financial performance of BTLP for the current and comparative periods have been presented separately as discontinued operations in the consolidated statements of operations and comprehensive income (loss) and cash flows.

Summary of financial information of the BTLP

As at January 31,		2018		2017
Assets				
Cash	$	1,341,441	$	32,659
Other current assets		1,072,710		711,400
Property and equipment		34,141,558		19,214,947
	$	36,555,709	$	19,959,006
Liabilities				
Current liabilities	$	1,459,745	$	1,695,725
Decommissioning obligations		159,776		67,983
	$	1,619,521	$	1,763,708

For the year ended January 31,		2018		2017
Revenue	$	4,133,674	$	1,119,022
Direct operating costs				
Production and operating		1,184,135		686,972
Depreciation and depletion		4,338,838		1,241,601
Operating loss		(1,389,299)		(809,551)
Other expenses		90,601		254,504
Accretion		19,054		16,313
Impairment		11,529,004		5,355,827
Loss before income taxes	$	(13,027,958)		(6,436,195)
Net loss and comprehensive loss for the year	$	(13,027,958)	$	(6,436,195)

The BTLP has a fiscal year-end of December 31. Adjustments for material transactions between December 31, 2017 and January 31, 2018 have been made to adjust for the non-coterminous year-ends.

(Expressed in United States Dollars)

6. EXPLORATION AND EVALUATION ASSETS

	STS Olmos	STS South Lease	Total
Balance – January 31, 2016	**$ 2,354,186**	**$ 1,341,112**	**$ 3,695,298**
Acquisition costs	-	9,575	9,575
Exploration and evaluation	83,076	-	83,076
Expenditures during the year	83,076	9,575	92,651
Effect of changes in foreign exchange rates	-	86,116	86,116
Disposition (Note 4)	(2,437,262)	(1,436,803)	(3,874,065)
Balance – January 31, 2017	**-**	**-**	**-**
Acquisition costs	**-**	**-**	**-**
Exploration and evaluation	**-**	**-**	**-**
Expenditures during the year	**-**	**-**	**-**
Effect of changes in foreign exchange rates	**-**	**-**	**-**
Balance – January 31, 2018	**$ -**	**$ -**	**$ -**

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

(Expressed in United States Dollars)

7. PROPERTY AND EQUIPMENT

Cost	Other Equipment	Leaseholds	Oil and Gas	Total
Balance – January 31, 2016	**$ 137,722**	**$ 117,172**	**$ 32,294,162**	**$ 32,549,056**
Effect of changes in foreign exchange rates	3,541	3,696	-	7,237
Disposition (Note 4)	-	-	(32,294,162)	(32,294,162)
Balance – January 31, 2017	**141,263**	**120,868**	**-**	**262,131**
Effect of changes in foreign exchange rates		9,532	-	9,532
Balance – January 31, 2018	**$ 141,263**	**$ 130,400**	**$ -**	**$ 271,663**
Accumulated depreciation and depletion				
Balance – January 31, 2016	**$ 111,006**	**$ 50,969**	**$ 9,129,525**	**$9,291,500**
Charge for year	35,917	20,967	837,821	894,705
Disposition (Note 4)	-	-	(9,967,346)	(9,967,346)
Effect of changes in foreign exchange rates	(5,660)	(332)	-	(5,992)
Balance – January 31, 2017	**141,263**	**71,604**	**-**	**212,867**
Charge for year	-	35,082	-	35,082
Effect of changes in foreign exchange rates	-	4,588	-	4,588
Balance – January 31, 2018	**$ 141,263**	**$ 111,274**	**$ -**	**$ 252,537**
Net book value				
Balance – January 31, 2017	**$ -**	**$ 49,264**	**$ -**	**$ 49,264**
Balance – January 31, 2018	**$ -**	**$ 19,126**	**$ -**	**$ 19,126**

8. CREDIT FACILITY

On June 6, 2014, Terrace STS entered into a senior unsecured term credit facility (the “Credit Facility”), which is non-recourse to the Company, to fund the development of its STS Olmos Project in McMullen and LaSalle counties in south Texas. At inception, the aggregate amount of the Credit Facility was $75 million, of which $50 million was available to be drawn at the discretion of Terrace STS. The original term of the facility was four years with cash interest of LIBOR (with a floor of 1%) plus 7% plus accrued principal (“PIK”) interest of 5% per annum. Cash interest was to be paid monthly; principal and PIK interest were to be paid upon maturity on May 31, 2018.

During the year ended January 31, 2015, Terrace STS made an initial draw of $25 million and received net proceeds of $24 million after deducting the agreed-upon transaction cost of $1 million. Terrace STS also incurred $1.4 million of legal and other additional costs, which have been netted against the balance outstanding under the facility and were being amortized into interest expense over the term of the Credit Facility.

The terms of the Credit Facility provided for certain covenants, including the requirement to maintain certain financial condition covenants.

As at January 31, 2015, Terrace STS was not in compliance with the asset coverage ratio and the leverage ratio pursuant to the agreement. The lender provided Terrace STS a waiver of the non-compliance at January 31, 2015 and for the expected non-compliance for the quarter ended April 30, 2015. As a condition of the waivers and reset of the covenants granted by the lender, Terrace STS agreed to increase the interest rate margin from 7% to 8% beginning June 1, 2016 and pledged the assets of Terrace STS as collateral to the Credit Facility. In addition, Terrace STS agreed to reduce the amount available to be drawn under the facility to the $25 million that was outstanding as of January 31, 2016. Terrace STS also agreed to devise a plan acceptable to the lender to enhance the overall capitalization of Terrace STS by August 31, 2015. At August 31, 2015 and January 31, 2016, Terrace STS was not in compliance with the

(Expressed in United States Dollars)

8. CREDIT FACILITY (Continued)

adjusted leverage ratio requirement. The Company and its financial advisor continued to evaluate financial options and strategic alternatives that could ultimately result in an enhanced capitalization of Terrace STS; however, the Company was unable to provide a satisfactory plan to the lender. As a result of the non-compliance of the credit agreement requirements, the lender declared a default during February 2016 and asserted default interest of 5% per annum back to the original date of non-compliance of August 31, 2015.

Terrace STS was unable to cure the default with its secured lender. The Company and the lender, as a consequence, entered into an agreement on May 20, 2016 whereby the lender converted its secured debt, in the amount of $24,964,995 (including accrued interest) into 95% of the membership units of Terrace STS (Note 4). Upon closing of the transaction, Terrace STS was deconsolidated from the financial statements of the Company.

The credit facility balance converted into membership units as of May 20, 2016 consisted of the following:

Balance at January 31, 2016		**25,443,375**
Amortization of financing costs		286,316
PIK interest		414,475
Principal repayment		(1,709,820)
Balance at May 20, 2016		24,434,346
Accrued but unpaid interest at May 20, 2016		530,649
Credit Facility obligations converted into equity in Terrace STS	$	24,964,995

9. CONVERTIBLE NOTES

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

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

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

(Expressed in United States Dollars)

9. CONVERTIBLE NOTES (Continued)

Notes are redeemed in accordance with their terms at any time within 180 days prior to the Maturity Date, one-half of the Maturity Bonus will be payable.

Carrying value of secured assets at January 31, 2018:

Cash	$	1,421,810
Accounts receivable		17,281
Prepaids		62,010
Property and equipment		19,126
	$	1,520,227

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

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

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

At January 31, 2018, CAD $38,265,000 of notes were outstanding and convertible into 76,530,000 shares (2017 - CAD $38,265,000). The following table reconciles the carrying amount of the Existing Notes from January 31, 2015 through May 13, 2016:

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

(Expressed in United States Dollars)

9. CONVERTIBLE NOTES (Continued)

The following table reconciles the carrying amount of the New Notes from May 13, 2016 through January 31, 2018:

	Liability	Equity	Total
Issuance of New Notes on May 13, 2016	$ 11,769,496	$ 2,029,170	$ 13,798,666
Accretion of discount	1,807,487	-	1,807,487
Conversion of notes	(247,562)	(25,974)	(273,536)
Effect of changes in foreign exchange rates	53,198	-	53,198
Balance, January 31, 2017	**13,382,619**	**2,003,196**	**15,385,815**
Accretion of discount	2,991,233	-	2,991,233
Effect of changes in foreign exchange rates	954,797	-	954,797
Balance, January 31, 2018	**$ 17,328,649**	**$ 2,003,196**	**$ 19,331,845**

10. CAPITAL STOCK

The Company has unlimited authorized common shares without par value. At January 31, 2018, the Company has 88,494,821 (2017 – 88,494,821) shares outstanding.

Share issues

During the year ended January 31, 2018, the Company did not issue any common shares.

During the year ended January 31, 2017, the Company issued 650,000 common shares on the conversion of CAD $325,000 convertible notes.

Restricted share units

The Company has a restricted share unit plan (the “RSU Plan”) that permits the issuance of an aggregate 3,682,182 RSUs to eligible participants, as described in the RSU Plan. RSUs do not confer on the holder any right to vote at a meeting of the shareholders of the Company. Common shares reserved for issuance under outstanding RSUs must be included in the calculation of common shares remaining available for reservation pursuant to options granted under the 10% rolling option plan. The number of common shares reserved for issuance, together with any other compensation arrangements, to any one person in any twelve-month period will not exceed 5% of the issued and outstanding common shares. The number of common shares reserved for issuance together with any other compensation arrangements granted to all technical consultants will not exceed 2% of the issued and outstanding common shares. The number of RSUs granted to any one person cannot exceed 5% of the issued and outstanding common shares.

As at January 31, 2018, the Company has 700,000 (2017 – 700,000) RSUs outstanding with a grant date fair value of CAD $2,742,208 based on the stock prices at the time of grant. Each RSU, upon vesting, gives the holder the right to receive one common share. Unless otherwise approved by the Company's Board of Directors, all of the RSUs will vest upon the occurrence of a "change of control transaction", as such term is defined in the RSU award agreements. In the absence of a change of control transaction or other acceleration of vesting by the Company’s Board of Directors, unvested RSUs will expire ten years from the date of grant. Vested RSUs will be settled, at the election of the Company, by way of: (i) issuance of common shares from treasury; (ii) payment to the RSU holder of an amount of cash equal to the market price of the common shares on the vesting date; or (iii) any combination thereof.

(Expressed in United States Dollars)

10. CAPITAL STOCK (Continued)

The Company recognizes compensation expense for the expected number of RSUs expected to vest over the vesting period. As of January 31, 2018 and 2017, there are no contemplated transactions that would give rise to vesting; therefore, no compensation expense has been recognized.

Stock options

The Company has an incentive stock option plan, which provides that the Board of Directors of the Company may from time to time, in its discretion, and in accordance with Exchange requirements, grant to directors, officers, employees and technical consultants of the Company, non-transferable options to purchase common shares, provided that the number of common shares reserved for issuance will not exceed 10% of the issued and outstanding common shares. The number of common shares reserved for issuance pursuant to options granted to all technical consultants will not exceed 2% of the issued and outstanding common shares. The number of options granted to any one person cannot exceed 5% of the issued and outstanding common shares. Such options may be exercisable for a period of up to ten years from the date of grant. Vesting terms vary and will be determined at the time of grant by the Board of Directors.

Outstanding stock options and warrants

The weighted average exercise price of the outstanding stock options at January 31, 2018 is CAD $nil (2017 - CAD $1.35). There have been no stock options granted during the years ended January 31, 2018 and 2017. There were 2,650,000 options with an average exercise price of CAD $0.19 that expired during the year ended January 31, 2017. There were 150,000 options with an average exercise price of CAD $1.35 that expired during the year ended January 31, 2018. (2017 - 2,650,000 options with an average exercise price of CAD $0.19).

At January 31, 2018 there were no options or warrants outstanding.

11. FINANCING EXPENSES

	Year ended January 31,	
	2018	**2017**
Continuing Operations:		
Interest expense	$ -	$ 642,632
Accretion of convertible notes	2,991,233	2,009,301
Total financing expense from continuing operations	2,991,233	2,651,933
Discontinued Operations:		
Interest expense	-	1,160,529
Accretion of decommissioning obligations	-	2,566
Amortization of financing costs	-	286,316
PIK interest	-	414,475
Total financing expense from discontinued operations	-	1,863,886
Total	$ 2,991,233	$ 4,515,819

12. FINANCIAL INSTRUMENTS

The Company has classified its financial instruments as follows:

- Cash – as FVTPL;
- Accounts receivable and operators bond – as loans and receivables; and
- Accounts payable and accrued liabilities and convertible notes – as other financial liabilities.

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

Fair value

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

Credit risk

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

The Company's credit risk is primarily attributable to its cash and accounts receivable. The credit risk associated with cash is mitigated since the cash is held at major financial institutions with high credit ratings. At January 31, 2018 and 2017, the Company has no trade receivables, and therefore is no longer exposed to credit risk from these financial assets.

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

(ii) Foreign currency risk

Foreign currency risk is the risk that the future cash flow of financial instruments will fluctuate as a result of changes in foreign exchange rates. The Company's functional currency is CAD and its subsidiaries' functional currencies are CAD and USD. Transactions relating to its oil and gas properties are in USD. Therefore, the Company is impacted by changes in the exchange rate between Canadian and US dollars.

(Expressed in United States Dollars)

12. FINANCIAL INSTRUMENTS (Continued)

Market risk (continued)

(ii) Foreign currency risk (continued)

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

		2018		2017
Cash	$	1,398,455	$	2,485,985
Accounts receivable		11,687		10,650
Operator's bond		-		25,000
Accounts payable and accrued liabilities		(570,854)		(526,810)
Net	$	839,288	$	1,994,825

Based on the above net exposure, a 5% change in the Canadian/US exchange rate would impact the Company's net income (loss) and comprehensive income (loss) by approximately $41,964 (2017 - $99,741).

(iii) Other price risk

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

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in satisfying financial obligations as they become due. The Company manages liquidity risk through maintaining sufficient cash on hand to meet its obligations as they become due. As at January 31, 2018, the Company had cash of $1,421,810 (2017 - $2,532,786), accounts receivable of $17,281 (2017 - $22,014), and current liabilities of $630,868 (2017 - $652,323). Current liabilities of $130,868 are due within three months of January 31, 2018. The remaining $500,000 balance relates to a contingent liability recorded for provision of the asserted liquidated damages (see Note 14).

The Convertible Notes of the Company (note 9) represent a long-term debt obligation that will mature in 2021. The Company's business approach is focused on acquiring and managing assets to meet this obligation. There are; however, no assurances that the Company's plans will produce sufficient net revenues to pay out this debt.

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

(Expressed in United States Dollars)

12. FINANCIAL INSTRUMENTS (Continued)

Classification of financial instruments

The following table sets forth the fair value of the Company's financial assets and financial liabilities within the fair value hierarchy as at January 31, 2018.

		Level 1		Level 2		Level 3
Cash	$	1,421,810	$	-	$	-
Convertible notes		(129,802)		-		-
	$	1,292,008	$	-	$	-

The following table sets forth the fair value of the Company's financial assets and financial liabilities within the fair value hierarchy as at January 31, 2017.

		Level 1		Level 2		Level 3
Cash	$	2,532,786	$	-	$	-
Convertible notes		(2,940,747)		-		-
	$	(407,961)	$	-	$	-

13. CAPITAL DISCLOSURES

The Company considers its capital under management to be shareholders' deficit and convertible notes. The Company's capital management objectives are to ensure the Company continues as a going concern, as well as to maintain optimal returns to shareholders and benefits for other stakeholders. The Board of Directors does not establish quantitative criteria for management, but rather relies on management expertise to sustain future development. Management will adjust the capital structure as necessary to achieve the objectives.

The Company's capital management strategy has not changed during the year ended January 31, 2018.

14. COMMITMENTS AND CONTINGENCIES

The Company has a commitment to make monthly rental payments pursuant to an office rental agreement in Vancouver, British Columbia, which commenced July 1, 2013 for a term of seven years. The lease requires total annual payments of CAD $72,511 in years three, four and five, and CAD $76,198 in years six and seven. In December 2015, the Company entered into a sublease of the office space commencing February 1, 2016 through the remaining term of the lease for CAD $58,992 per year.

Total rent expense net of sublease payments included in the consolidated statements of operations and comprehensive income (loss) for the year ended January 31, 2018 amounted to $75,166 (2017 - $58,875).

At January 31, 2018, the Company had convertible notes outstanding in the face amount of CAD $38,265,000 that do not pay interest and are due April 2, 2021 (Note 9).

During April 2015, the Company entered into an agreement, through a wholly owned subsidiary, to earn a 75% working interest and a 52.5% net revenue interest, as to the Olmos formation only, in certain leases covering initially 640 gross mineral acres in LaSalle County, Texas. Under the terms of this agreement, the Company was required to commence drilling a well (paying 100% of the cost) on this acreage by late September 2015 or pay liquidated damages of $500,000. Due to the severe drop in commodity prices, the Company declared the agreement to be in a state of *force majeure* in accordance with the applicable terms of the agreement, effectively placing its obligations on hold until market conditions improve sufficiently to allow for economic development of the acreage. The farmor disputed this declaration and filed suit to enforce the liquidated damages clause of the agreement. In June 2016 the court upheld the farmor's motion for summary judgment against the wholly owned subsidiary. Accordingly the Company has recorded a provision in the amount of the asserted liquidated damages of $500,000, included in accounts payable and

(Expressed in United States Dollars)

14. COMMITMENTS AND CONTINGENCIES (Continued)

accrued liabilities. The Company will continue to vigorously defend its position. The Company has appealed the court ruling including a counter-claim against the farmor for damages relating to breach of contract. The Company has filed affidavits with the courts as to the financial condition of the subsidiary which blocks any further attempts at collection on the judgement.

15. RELATED PARTY TRANSACTIONS

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

	Year ended January 31, 2018	2017
Short-term compensation	$ 708,932	$ 996,618
Recoveries from consulting and management services revenue	(321,398)	(840,990)
	$ 387,534	$ 155,628

During the year ended January 31, 2017, management and staff voluntarily modified their employment contracts to reduce salaries and eliminate key long-term employment benefits. The Company established a third party consulting practice to cover salaries for technical personnel. At January 31, 2018, these changes resulted in recoveries of $212,374 (2017 - $840,990).

At January 31, 2018, convertible notes held by key management personnel and their close family members totalled CAD $3,230,000 (2017 - CAD $3,230,000). No interest was paid on these convertible notes in 2018 and 2017.

16. SEGMENTED INFORMATION

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

2018	USA	Canada	Total
Property and equipment	$ -	$ 19,126	$ 19,126
Assets held for sale	4,826,382	-	4,826,382
	$ 4,826,382	$ 19,126	$ 4,845,508

2017	USA	Canada	Total
Property and equipment	$ 9,879	$ 39,385	$ 49,264
Investment in partnership	5,105,697	-	5,105,697
	$ 5,115,576	$ 39,385	$ 5,154,961

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

(Expressed in United States Dollars)

17. SUPPLEMENTAL CASH FLOW INFORMATION

During the year ended January 31, 2018, the Company:

a) transferred $153,375 from stock option reserves to deficit on the expiration of options.

During the year ended January 31, 2017, the Company:

a) disposed of subsidiary assets totaling $24,922,070, consisting of cash of $1,016,948, accounts receivable of $220,766, prepaids of $2,336, and exploration and evaluation and property and equipment of $25,312,879 in exchange for settlement of debt, and transferred liabilities totaling $1,630,859 consisting of accounts payable and accrued liabilities of $1,118,381 and decommissioning obligations of $512,478;

b) converted Credit Facility principal and interest of $24,964,995 into equity in Terrace STS on May 20, 2016 and as a result deconsolidated the assets, which were included in assets held for sale at the time of the transaction totaling $26,860,101 and the liabilities associated with the assets held for sale totaling $1,033,542 (see Note 4);

c) transferred $247,562 from the liability component of convertible notes and $25,974 from the equity component of convertible notes to capital stock on the conversion of convertible notes;

d) transferred $880,867 from stock option reserves to deficit on the expiration of options;

e) transferred $6,099 from warrant reserves to deficit on the expiration of warrants; and

f) paid $629,890 of interest, received $nil of interest and paid $nil income taxes.

18. EARNINGS (LOSS) PER SHARE

The calculation of basic and diluted earnings (loss) per share is based on the following:

	Year ended January 31,	
	2018	**2017**
Net income (loss) from continuing operations	$ (3,218,509)	$ 12,788,110
Net loss from discontinued operations	(279,315)	(9,340,041)
Basic weighted average number of common shares outstanding	88,484,821	88,057,321
Effect of dilutive securities	-	-
Diluted weighted average number of common shares outstanding	88,484,821	88,057,321
Continuing Operations:		
Basic and diluted earnings (loss) per share	$(0.04)	$0.15
Discontinued Operations		
Basic and diluted loss per share	$(0.00)	$(0.11)

(Expressed in United States Dollars)

19. INCOME TAXES

a) Income tax expense differs from the amount that would be computed by applying the Canadian statutory income tax rate of 26.08% (2017 - 26.00%) to income (loss) before income taxes. The reasons for the differences are as follows:

	2018	2017
Income (loss) before income taxes	$ (3,497,824)	$ 3,448,069
Statutory income tax rate	26.08%	26.00%
Expected income tax	(912,233)	896,498
Items not deductible for tax purposes	527,681	1,254,933
Differences between Canadian and foreign tax rates	(116,582)	(474,143)
Effect of change in tax rates	5,031,412	-
Temporary differences	1,603	(445,552)
Impact of foreign exchange on tax assets and liabilities	(115,178)	28,844
Changes in unrecognized deferred income tax assets	(4,416,703)	(1,260,580)
	$ -	$ -

b) The Company recognizes tax benefits on losses or other deductible amounts generated in countries where it is probable the Company will generate taxable income to recognize deferred tax assets. The Company's unrecognized deductible temporary differences and unused tax losses for which no deferred tax asset is recognized consist of the following amounts:

	2018	2017
Non-capital losses	$ 67,773,956	$ 87,111,574
Share issue costs	284,649	948,119
Other	180,901	491,503
	$ 68,239,506	$ 88,551,196

As at January 31, 2018, the Company's unused tax losses have the following expiry years:

2031 and before	$ 180,965
2032	102,584
2033	425,553
2034	9,771,557
2035	16,361,726
2036	10,940,782
2037	27,881,343
2038	2,109,446
	$ 67,773,956