TORC

Oil & Gas Ltd

2011 Annual Report

For the year ended December 31, 2011

TORC Oil & Gas Ltd. ("TORC" or the "Company") is pleased to announce its financial and operating results for the year ended December 31, 2011.

In this report, all references to barrels of oil equivalent ("Boe") are calculated by converting natural gas to oil at a ratio of six thousand cubic feet of natural gas to one barrel of oil.

President's Letter to Shareholders

2011 represented the first full year of operations for our Tight Oil Resource Company and was highlighted by the successful execution of our business strategy. Since inception, our strategy at TORC Oil & Gas Ltd. has been defined by three phases. The first phase of the Company's strategy was to focus on the accumulation of resource prone acreage, or the Resource Capture Phase. The second phase, or Delineation Phase, is where the primary focus is on strategic drilling to define TORC's resource base. Once the resource base has been captured and delineated, the primary focus will be on the third phase, the efficient development of the Company's resource portfolio, or the Production Growth Phase.

To execute this strategy, the Company raised $298 million in 2011 in four equity raises ($6 million at $1.50 per share in January, $125 million at $3.00 per share in February, $125 million at $4.00 per share in June, and $42 million at $4.80 per flow-through share in September) which positioned the Company to complete over 30 strategic land acquisitions and enter into several farm-in transactions to build a material light oil prone land position in Alberta.

The first half of 2011 was dominated by the execution of TORC's Resource Capture Phase, focused in two primary areas, Cardium light oil development acreage and emerging light oil exploration acreage in southern Alberta.

Through numerous transactions TORC successfully established a position of over 60 net sections of Cardium light oil prone acreage. These lands provide a solid base of highly economic development locations to underpin the future production growth of the Company. TORC has been focused on prospective Cardium sand trends west of Pembina where identifiable original-oil-in-place is over five million barrels per section. Additionally, in order to maximize Cardium resource capture while strategically delineating the Company's land position, TORC entered into a number of farm-in transactions. In 2011, the Company drilled 9 (6.6 net) Cardium wells of which seven were farm-in wells. The Company achieved a 100% success rate in its Cardium drilling program in 2011 and sees over 200 light oil development locations on its lands. TORC has continued with its Cardium farm-in program into 2012 as the Company executes on the Delineation Phase of its strategy.

TORC has also established a sizeable land position of over 300 net sections of light oil resource prone land in southern Alberta. TORC has focused its efforts on areas in southern Alberta where porosity has been preserved in and around known source rocks. This porosity provides the potential for increased storage of hydrocarbons in a given area, increasing the opportunity for economic success. In the first half of 2011, the Company drilled two exploration wells twelve miles apart testing its technical concepts of the area. The results of these wells encouraged the Company to actively pursue the consolidation of lands that met the Company's established technical criteria. Starting in the fourth quarter of 2011 the Company began further delineation drilling on its lands to further test technical concepts. In 2011, TORC drilled a total of 5 (4.6 net) wells in southern Alberta resulting in three oil wells, one strat test, and one D&A well. The Company has continued to be active in southern Alberta into 2012 with an additional eight wells planned in the first half of the year.

The second half of 2011 and into 2012 has represented a shift into the Delineation Phase of management's strategy. The Company continues to be proactive in the Resource Capture Phase based on delineation success, but the majority of its capital is now being directed to drilling and completion activity to further define TORC's asset base. In 2011, TORC drilled a total of 14 (11.2 net) wells with a 93% success rate. The initial results of the Delineation Phase have been encouraging and have identified a significant inventory which can be accessed once the Company moves into the Production Growth Phase.

(continued)

With $80 million of positive working capital at the beginning of the year, TORC is well positioned to continue to execute on management's strategy. In 2012, the Company will continue an active drilling program focused on the delineation of the Company's oil resource portfolio, consolidate assets on success, and continue to evaluate on-strategy acquisition opportunities in order to further position the Company for future production growth. TORC management has already identified a portfolio of light oil development opportunities on its asset base in excess of $1.5 billion in future capital spending to support this Production Growth Phase. 2012 will be an exciting year for TORC as management will continue to position the Company to be a significant producer in the Western Canadian Sedimentary Basin.

Please see www.torcoil.com for more information.

On behalf of the Board of Directors,

(signed)

Brett Herman
President & Chief Executive Officer
March 20, 2012

Highlights

(in thousands, except per share data)	Three months ended Dec 31, 2011	Year ended Dec 31, 2011
Financial		
Funds flow from operations [1]	$ 1,731	$ 521
Per share basic [2]	$ 0.01	$ 0.01
Per share diluted [2]	$ 0.01	$ 0.01
Net loss	$ (1,982)	$ (4,667)
Per share basic [2]	$ (0.02)	$ (0.05)
Per share diluted [2]	$ (0.02)	$ (0.05)
Exploration and development expenditures [3]	$ 38,892	$ 74,948
Acquisitions (cash and share consideration)	$ (1,927)	$ 157,961
Net working capital [4]	$ 81,138	$ 81,138
Common shares:		
Shares outstanding, end of period	121,433	121,433
Weighted average shares (basic)	121,433	95,834
Weighted average shares (fully diluted) [2]	121,433	95,834
Operations		
Production:		
Crude oil and NGL (Bbls per day)	348	94
Natural gas (Mcf per day)	216	147
Barrels of oil equivalent (Boepd, 6:1)	384	119
Average realized price:		
Crude oil and NGL ($ per Bbl)	$ 93.18	$ 92.48
Natural gas ($ per Mcf)	$ 3.22	$ 3.42
Barrels of oil equivalent ($ per Boe, 6:1)	$ 86.36	$ 77.84
Wells drilled:		
Gross	7	14
Net	5.7	11.2
Success (%)	86	93

(1) *Management uses funds flow from operations (before changes in non-cash working capital) to analyze operating performance and leverage. Funds flow as presented do not have any standardized meaning prescribed by International Financial Reporting Standards and therefore may not be comparable with the calculation of similar measures for other entities.*

(2) *The diluted number of shares is equivalent to the basic number of shares due to stock options, incentive shares and/or warrants being antidilutive as the Company has a net loss. Therefore, the diluted per share amounts for net loss and funds flow from operations are equivalent to the basic per share amounts.*

(3) *Exploration and development expenditures includes capitalized general and administrative expenses and administrative assets totaling $0.5 million and $2.7 million for the three months and year ended December 31, 2011, respectively.*

(4) *Net working capital is calculated as current assets less current liabilities and non-current deferred lease incentives.*

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis ("the MD&A") is dated March 20, 2012. The MD&A should be read in conjunction with TORC Oil & Gas Ltd.'s ("TORC" or the "Company") audited consolidated financial statements as at and for the year ended December 31, 2011. The reader should be aware that historical results are not necessarily indicative of future performance.

TORC was incorporated on March 23, 2010 as 1525893 Alberta Ltd. The Company's name was changed to TORC Oil & Gas Ltd. on December 17, 2010. For the year ended December 31, 2011, the Company's activities initially related to the strategic acquisition of undeveloped land and progressed towards drilling and production operations in the second half of the year. As a result, for the year ended December 31, 2011, the Company's non-capital related expenditures primarily consisted of general and administrative expenses. Until the Company begins to generate significant cash flow from operating activities, TORC has access to capital via current cash reserves, equity financings and credit facilities.

The financial data presented below has been prepared in accordance with International Financial Reporting Standards ("IFRS"), unless otherwise indicated.

Barrel of Oil Equivalent

Where amounts are expressed on a barrel of oil equivalent ("Boe") basis, natural gas volumes have been converted to Boe using a ratio of 6,000 cubic feet of natural gas to one barrel of oil equivalent. This conversion ratio is based upon an energy equivalent conversion method primarily applicable at the burner tip and does not represent value equivalence at the wellhead. Boe figures may be misleading, particularly if used in isolation.

Non-GAAP Measurements

The MD&A contains the terms "funds flow from operations" and "operating netback" which are not defined by IFRS and therefore may not be comparable to performance measures presented by others. Funds flow from operations represents cash flow from operating activities prior to changes in non-cash working capital. Operating netback represents revenue less royalties, realized hedging gains and losses, operating expenses and transportation expenses. Management believes that in addition to net income, funds flow from operations and operating netback are useful supplemental measures as they assist in the determination of the Company's operating performance, leverage and liquidity. Investors should be cautioned, however, that these measures should not be construed as an alternative to both net income and net cash used in operating activities, which are determined in accordance with IFRS, as indicators of the Company's performance.

The reconciliation between funds flow from operations, as defined above, and net cash used in operating activities, as defined by IFRS, is as follows:

($ thousands)	**Three months ended Dec 31, 2011**	Three months ended Dec 31, 2010	**Year ended Dec 31, 2011**	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Funds flow from operations (as defined above)	**$ 1,731**	$ (357)	**$ 521**	$ (441)
Changes in non-cash working capital	**(2,127)**	307	**(1,121)**	308
Net cash used in operating activities (as defined by IFRS)	**$ (396)**	$ (50)	**$ (600)**	$ (133)

TORC's reporting and measurement currency is the Canadian dollar. Amounts in this MD&A are in Canadian dollars unless otherwise stated.

Forward-Looking Statements

This document contains forward-looking statements. More particularly, this document contains statements concerning future exploration and development activities, the anticipated continuing volatility in crude and natural gas pricing, and the anticipated means of funding capital expenditures.

The forward-looking statements are based on certain key expectations and assumptions made by the Company, including anticipated economic and operating conditions, the availability of capital, prevailing commodity prices, the success of future drilling and development activities, the availability of labour and services, the geological nature of the formations targeted by the Company, and prevailing accounting standards.

Although the Company believes that the expectations and assumptions on which the forward-looking statements are based are reasonable, undue reliance should not be placed on the forward-looking statements because the Company can give no assurance that they will prove to be correct.

Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks. These include, but are not limited to, risks associated with the oil and gas industry in general (e.g., operational risks in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserve estimates; the uncertainty of estimates and projections relating to production, costs and expenses, and environmental, health, and safety risks), commodity price and exchange rate fluctuations, changes in applicable laws and policies and uncertainties resulting from potential delays or changes in plans with respect to exploration or development projects or capital expenditures. Certain of these risks are set out in more detail in this document.

The forward-looking statements contained in this document are made as of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise.

Results of Operations

For the year ended December 31, 2011, the Company's activities related initially to the acquisition of undeveloped land which it considers prospective for oil and natural gas development, and also saw the commencement of drilling and other operations related to production and development. As a result, for the year ended December 31, 2011, the Company's non-capital related expenditures primarily consisted of general and administrative expenses.

At the end of 2011, the Company had eight (5.8 net) producing wells. An additional five (4.8 net) wells have been successfully drilled and were awaiting either completion or equipping and tie-in.

Production

	Three months ended Dec 31, 2011	Three months ended Dec 31, 2010	**Year ended Dec 31, 2011**	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Crude oil and NGL (Bbl per day) [(1) (2)]	**348**	-	**94**	-
Natural gas (Mcf per day) [(3)]	**216**	-	**147**	-
Total (Boe per day)	**384**	-	**119**	-

(1) "NGL" refers to natural gas liquids.
(2) "Bbl" refers to barrels.
(3) "Mcf" refers to thousand cubic feet.

Pricing

	Three months ended Dec 31, 2011	Three months ended Dec 31, 2010	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Average realized prices:				
Crude oil and NGL ($ per Bbl)	**$ 93.18**	$ -	**$ 92.48**	$ -
Natural gas ($ per Mcf)	**3.22**	-	**3.42**	-
Boe ($ per Boe)	**$ 86.36**	$ -	**$ 77.84**	$ -

	Three months ended Dec 31, 2011	Three months ended Dec 31, 2010	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Average Benchmark Prices:				
Crude oil – WTI *(US$ per Bbl)*	**94.06**	85.17	**95.12**	79.53
Crude oil – Edmonton Par *(CDN$ per Bbl)*	**97.86**	80.68	**95.52**	77.82
Natural gas – AECO Daily Spot *($ per Mcf)*	**2.89**	3.29	**3.28**	3.62
Natural gas – AECO Monthly Spot *($ per Mcf)*	**3.12**	3.22	**3.31**	3.72
Exchange rate – *(CDN$/US$)*	**1.02**	1.01	**0.99**	0.99

Revenues

($ thousands)	Three months ended Dec 31, 2011	Three months ended Dec 31, 2010	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Crude oil and NGL	**$ 2,981**	$ -	**$ 3,178**	$ -
Natural gas	**68**	-	**191**	-
	$ 3,049	$ -	**$ 3,369**	$ -

Royalties

($ thousands, unless otherwise noted)	Three months ended Dec 31, 2011	Three months ended Dec 31, 2010	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Royalties	**$ 263**	$ -	**$ 293**	$ -
Percentage of revenue	**8.6%**	-	**8.7%**	-

Operating Expenses

For the three months and year ended December 31, 2011, the Company's operating expenses were $0.3 million ($9.27 per Boe) and $0.4 million ($9.36 per Boe), respectively. For the three months ended December 31, 2010 and the period since incorporation on March 23, 2010 to December 31, 2010 (the "Corresponding Periods"), the Company did not incur any operating expenses.

Transportation Expenses

For the three months and year ended December 31, 2011, the Company's transportation expenses were $0.2 million ($6.52 per Boe) and $0.2 million ($5.72 per Boe), respectively. In the Corresponding Periods, the Company did not incur any transportation expenses.

Operating Netbacks

($ per Boe, unless otherwise noted)	**Three months ended Dec 31, 2011**	Three months ended Dec 31, 2010	**Year ended Dec 31, 2011**	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Total production *(Boepd)*	**384**	-	**119**	-
Crude oil and NGL *($ per Bbl)*	**$ 93.18**	$ -	**$ 92.48**	$ -
Natural gas *($ per Mcf)*	**3.22**	-	**3.42**	-
Average Price	**86.36**	-	**77.84**	-
Royalties	**7.45**	-	**6.77**	-
Operating	**9.27**	-	**9.36**	-
Transportation	**6.52**	-	**5.72**	-
Operating Netback	**$ 63.12**	$ -	**$ 55.99**	$ -

General and Administrative Expenses

During the three months and year ended December 31, 2011, the Company incurred the following general and administrative expenses ("G&A"):

($ thousands)	**Three months ended Dec 31, 2011**	Three months ended Dec 31, 2010	**Year ended Dec 31, 2011**	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Consulting and professional	**$ 162**	$ 126	**$ 536**	$ 144
Office and personnel	**1,536**	236	**5,231**	410
Transaction related	**-**	191	**-**	191
	1,698	553	**5,767**	745
Recoveries (1)	**(376)**	-	**(641)**	-
Capitalized general and administrative expenses (2)	**(518)**	(196)	**(2,415)**	(304)
Total general and administrative	**$ 804**	$ 357	**$ 2,711**	$ 441
G&A per Boe – ($ per Boe)	**$ 22.78**	NMF	**$ 62.62**	NMF

"NMF" No Meaningful Figure.

(1) Recoveries refers to those G&A expenditures which under industry practice are reclassified to operating expenses, exploration and evaluation assets, or property, plant and equipment, dependent on their nature.

(2) Capitalized general and administrative expenses are those G&A expenditures which are directly attributable to the acquisition or exploration activities of the Company, and are therefore reclassified to exploration and evaluation assets, or property, plant and equipment, dependent on their nature.

Stock-Based Compensation Expenses

The Company's stock-based compensation expenses for the three months and year ended December 31, 2011 were $0.5 million and $1.4 million, respectively. The stock-based compensation expenses reflect the value ascribed to the non-cash compensation provided by the Company, and were calculated utilizing a fair value assessment methodology. These amounts are net of stock-based compensation costs capitalized to exploration and evaluation assets, and property, plant and equipment when they are related to exploration or acquisition activities. For the three months and year ended December 31, 2011, the Company capitalized stock-based compensation expenses of $0.7 million and $1.7 million, respectively.

($ thousands)	**Three months ended Dec 31, 2011**	Three months ended Dec 31, 2010	**Year ended Dec 31, 2011**	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Stock-based compensation expenses	**$ 1,206**	$ 44	**$ 3,106**	$ 44
Capitalized stock-based compensation expenses	**(663)**	(26)	**(1,708)**	(26)
	$ 543	$ 18	**$ 1,398**	$ 18

Finance Costs (Income)

($ thousands)	**Three months ended Dec 31, 2011**	Three months ended Dec 31, 2010	**Year ended Dec 31, 2011**	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Interest income	**$ (306)**	$ -	**$ (851)**	$ -
Financing charges [1]	**-**	-	**42**	-
	(306)	-	**(809)**	-
Accretion on decommissioning obligations	**2**	-	**2**	-
	$ (304)	$ -	**$ (807)**	$ -

(1) Financing charges relate to the Company's $50 million credit facility described in *Liquidity and Capital Resources* below.

Under IFRS, non-cash accretion expenses related to decommissioning obligations are presented as part of finance costs.

Depletion and Depreciation Expenses

For the three months and year ended December 31, 2011, the Company's depletion and depreciation expenses were $1.5 million ($42.14 per Boe) and $2.0 million ($45.73 per Boe), respectively. In the Corresponding Periods, the Company did not incur any depletion and depreciation expenses.

Taxes

For the three months and year ended December 31, 2011, the Company recorded deferred income tax expenses of $1.7 million and $1.8 million, respectively (Corresponding Periods: deferred income tax recoveries of $0.08 million and $0.1 million, respectively). The deferred income tax expenses in the year ended December 31, 2011 arise principally due to the deferred tax liability recorded as flow-through share expenditures were incurred.

Net Loss

The net loss for the three months and year ended December 31, 2011 were $2.0 million and $4.7 million, respectively (Corresponding Periods: $0.3 million and $0.4 million, respectively).

Basic and diluted net loss per share for the three months and year ended December 31, 2011 were $0.02 and $0.05, respectively (Corresponding Periods: $0.03 and $0.04, respectively).

Funds Flow from Operations

Funds flow from operations for the three months and year ended December 31, 2011 were $1.7 million and $0.5 million, respectively (Corresponding Periods: funds outflow from operations of $0.4 million and $0.4 million, respectively). As discussed above, the Company was largely in a land accumulation and early operational stage where non-capital expenditures primarily consisted of general and administrative expenses.

Capital Expenditures

Capital expenditures are summarized as follows:

($ thousands)	**Three months ended Dec 31, 2011**	Three months ended Dec 31, 2010	**Year ended Dec 31, 2011**	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Land retention costs	**$ (13)**	$ -	**$ 509**	$ -
Geological and geophysical	**(83)**	-	**1,616**	-
Drilling and completions	**33,875**	-	**63,759**	-
Equipment and facilities	**4,589**	-	**6,327**	-
Administrative assets	**6**	-	**322**	-
Capitalized general and administrative expenses	**518**	196	**2,415**	304
Exploration and development expenditures	**38,892**	196	**74,948**	304
Property acquisitions (dispositions) [(1)]	**(1,927)**	14,242	**157,961**	19,507
Total capital expenditures	**$ 36,965**	$ 14,438	**$ 232,909**	$ 19,811

(1) For the year ended December 31, 2011, includes consideration paid in February 2011 of 7,570,979 Common Shares at a deemed price of $3.00 per share.

The Company anticipates that its exploration and development capital program for 2012 (excluding acquisitions and dispositions) will be financed primarily through cash on hand, proceeds from equity issuances, bank debt and funds flow from operations.

The Company does not set a budget for acquisitions. When making acquisitions, the Company considers opportunities that align with strategic parameters and evaluates and finances each prospect on a case-by-case basis.

Share Capital

	Three months ended Dec 31, 2011	Three months ended Dec 31, 2010	**Year ended Dec 31, 2011**	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Weighted average outstanding common shares:				
Basic	**121,432,819**	10,309,870	**95,833,852**	8,109,071
Diluted [(1)]	**121,432,819**	10,309,870	**95,833,852**	8,109,071
Outstanding Securities:				
Common shares	**121,432,819**	27,049,000	**121,432,819**	27,049,000
Stock options	**6,298,200**	1,127,840	**6,298,200**	1,127,840
Incentive shares	**899,700**	-	**899,700**	-
Warrants	**20,000,000**	20,000,000	**20,000,000**	20,000,000

(1) The diluted number of shares is equivalent to the basic number of shares due to stock options, incentive shares and/or warrants being antidilutive as the Company has a net loss. Therefore, the diluted per share amounts for net loss and funds flow from operations are equivalent to the basic per share amounts.

The Company is authorized to issue an unlimited number of Class A voting common shares, an unlimited number of Class B non-voting common shares and an unlimited number of preferred shares.

Liquidity and Capital Resources

Since January 1, 2011, the Company has issued 94,383,819 Common Shares for total gross proceeds of $321.8 million.

On March 20, 2012, the Company had in place a $50.0 million credit facility arranged in February 2011 with a major Canadian bank. The credit facility provides that advances may be made by way of direct advances, bankers acceptances, or standby letters of credit/guarantees. The banker's acceptances and standby letters of credit/guarantees bear interest at the applicable banker's acceptance rate, plus a customary stamping fee. Direct advances bear interest at the bank's prime lending rate for Canadian dollar advances and at the bank's U.S. base rate for U.S. dollar advances. The credit facility is convertible to a borrowing base facility based on the Company's proven reserves. There are no standby fees on this credit facility.

The amount available under the facility depends on the amount of cash and cash equivalents held, up to $25.0 million, and an additional borrowing base amount of up to $25.0 million for the purpose of buying assets with proven reserves. The amount available under the facility is reduced by outstanding letters of credit, which totaled $2.0 million as at December 31, 2011 (December 31, 2010 - $nil). As a result, the amount available under the facility at December 31, 2011 was $23.0 million. The credit facility is secured by a fixed and floating charge debenture on the assets of the Company. The borrowing base is subject to semi-annual review by the bank.

Risk Management - Financial Instruments

From time to time, the Company may enter into commodity price, interest rate and foreign exchange rate derivative contracts (also known as hedges) in order to protect acquisition economics and provide some stability of cash flows for capital spending planning purposes. Commodity prices, interest rates and foreign exchange rates fluctuate due to economic and political events. As well, commodity prices may fluctuate due to meteorological conditions and changes in supply and demand. The Company's risk management activities are conducted pursuant to the Company's risk management policies approved by the Board of Directors.

At December 31, 2011, the Company did not have any derivative contracts or hedges outstanding.

Contractual Obligations

Flow-through shares

In December 2010, the Company issued 5,000,000 Flow-through Shares at a price of $1.00 per share for gross proceeds of $5.0 million. As a result, the Company had to incur qualifying resource expenditures amounting to $5.0 million before December 31, 2011. The qualifying expenditures were renounced to shareholders as at December 31, 2010. As at December 31, 2011, all qualifying resource expenditures related to this flow-through share issue had been incurred and as a result, there is no obligation remaining for this flow-through share issue.

In September 2011, the Company issued 8,701,000 Flow-through Shares at a price of $4.80 per share for gross proceeds of $41.8 million. As a result, the Company must incur qualifying resource expenditures amounting to $41.8 million before December 31, 2012. The qualifying expenditures were renounced to shareholders as at December 31, 2011. The obligation remaining for this flow-through share issue was $22.4 million as at December 31, 2011.

Operating commitments

The Company is, or will be, obligated to pay various costs associated with operations incurred in the normal course of business. These costs include royalties paid to provincial governments, surface lease rentals and mineral rights to various landowners, abandonment and reclamation costs and office leases. These costs are highly dependent on the future operating environment and are subject to changes in commodity prices, ownership, production volumes and government policies.

Working capital

During the land accumulation and initial operations stages, the Company is dependent on cash on hand, future financings from equity issues and/or debt. There is little or no positive cash flow from operating activities during this period. Working capital is expected to remain positive, with the Company closely monitoring its capital and administrative expenditures.

The Company manages the pace of its capital spending related to drilling operations by continuously monitoring production, commodity prices and resulting cash flows. Should circumstances affect cash flow in a detrimental way, the Company is capable of reducing its capital spending levels.

During the capital intensive exploration, drilling and production phase, the Company may create a negative working capital position. The Company will prudently manage its borrowings in relation to its credit capacity.

The industry has a pre-arranged monthly clearing day for payment of revenues from all buyers of crude oil, NGL and natural gas. This occurs on the 25th day following the month of sale. As a result, the Company's production revenues will be collected in an orderly fashion. To the extent that the Company has joint venture partners in its activities it will collect on a monthly basis the partners' share of capital and operating expenses. These are subject to normal collection risk.

Accounts payable consist of amounts payable to suppliers relating to capital spending, field operating activities and office expenses. These invoices are processed within the Company's normal payment cycle.

Farm-in transactions

The Company has entered into a number of farm-in agreements with third parties to earn interests in additional prospective acreage. At December 31, 2011, the Company's required future commitments are estimated to be $24 million, which are expected to be completed by the end of 2013 and form part of the Company's on-going capital program.

Business Conditions and Risks

The Company is engaged in the acquisition, exploration, development and production of crude oil and natural gas assets. TORC's business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates, currency exchange rates, and the ability to access debt and equity financing at reasonable cost. Operational risks include competition, environmental factors, reservoir performance uncertainties, a complex regulatory environment and safety concerns.

During the start-up and land accumulation phase, TORC uses its technical, technological and industry knowledge to evaluate potential hydrocarbon plays in order to pay what it believes are economically sound prices that benefit shareholders. The Company's focus is on areas in which the prospects are understood by management.

During its operational phases, the Company minimizes its business risks by operating a large number of its properties. This enables TORC to control the timing, direction and costs related to exploration and development opportunities. TORC's geological focus is on areas in which the prospects are understood by management. Technological tools are regularly used to reduce risk and increase the probability of success. The Company complies with all government regulations and has an up-to-date emergency response plan that has been communicated to field operations by management. The Company also carries insurance coverage to protect itself against potential losses. Maintaining a highly motivated and talented staff of petroleum and natural gas professionals further minimizes the business risk.

TORC relies on appropriate sources of funding to support the various stages of its business strategy:

- New equity, if available on favourable terms, may be utilized to fund acquisitions and to expand capital programs, when appropriate;
- Debt may be utilized to fund acquisitions and to expand capital programs; and
- Internally-generated cash flow from production will be used to fund business activities.

The Company is exposed to commodity price and market risk for its principal products of crude oil and natural gas. Commodity prices are influenced by a wide variety of factors, most of which are beyond TORC's control. To manage this risk, from time to time, the Company may enter into a number of financial derivative contracts for hedging purposes. These derivative contracts may include contracts related to crude oil and natural gas prices, as well as foreign exchange and interest rates. The Company may also, from time to time, enter into fixed physical contracts. The Company will monitor the cost and associated benefit of these instruments and contracts as well as any debt levels and utilization rates on bank lines, and will utilize these derivatives and contracts when warranted.

Inflation risks subject the Company to potential erosion of product netbacks. For example, increasing domestic prices for oil and natural gas production equipment and services can inflate the costs of operations. In addition, increasing costs of undeveloped land can inflate costs of both asset and corporate acquisitions.

The supply of service and production equipment at competitive prices is critical to the ability to add reserves at a reasonable cost and produce them in an economic and timely fashion. In periods of increased activity, these services and supplies can become difficult to obtain. The Company attempts to mitigate this risk by developing strong long-term relationships with suppliers and contractors and maintaining an appropriate inventory of production equipment.

Demand for crude oil, NGL and natural gas produced by the Company exists within Canada and the United States; however, crude oil prices are affected by worldwide supply and demand fundamentals while natural gas prices are currently primarily affected by North American supply and demand fundamentals. Demand for natural gas liquids is influenced mainly by the demand for petrochemicals in North American and off-shore markets. TORC mitigates these risks as follows:

- TORC attempts to explore for and produce crude oil that is of high quality, mitigating its exposure to adverse quality differentials;
- Natural gas production will generally be connected to established pipeline infrastructures that operate with minimal interruptions;
- Sale arrangements will vary in term and pricing structure creating a diverse portfolio that minimizes risk of exposure to any one market; and
- Financial derivative contracts may be used where appropriate to manage commodity price volatility.

Environmental Regulation and Risk

The oil and gas industry has various environmental risks subject to regulation by various governmental bodies. Environmental legislation includes, but is not limited to, operational controls, site restoration and abandonment requirements and restrictions on emissions of various substances related to the production of oil and natural gas. Compliance with this legislation may require additional costs and a failure to comply may result in fines and penalties.

TORC is committed to minimizing the environmental impact from its operations through an environmental program which includes stakeholder communication, resource conservation and site restoration.

Additional Information

Additional information can be obtained by contacting the Company at TORC Oil & Gas Ltd., Suite 1800, Eighth Avenue Place, 525 - 8th Avenue SW, Calgary, Alberta, Canada T2P 1G1 or by email at info@torcoil.com.

Summary of Quarterly Results

(in $000's of dollars, except per share amounts)	**Q4 2011** (1)	Q3 2011 (1)	Q2 2011 (1)	Q1 2011 (1)	Q4 2010 (1)	Q3 2010 (1)	Q2 2010 (1)	Period from incorporation to Mar 31, 2010 (1)
Net loss	**(1,982)**	(974)	(1,248)	(463)	(291)	(34)	(27)	(5)
Per share – basic	**(0.02)**	(0.01)	(0.01)	(0.01)	(0.03)	(0.01)	-	-
Per share – diluted	**(0.02)**	(0.01)	(0.01)	(0.01)	(0.03)	(0.01)	-	-
Funds flow from operations (2)	**1,731**	(336)	(504)	(370)	(357)	(43)	(35)	(7)
Per share – basic	**0.01**	-	(0.01)	(0.01)	(0.03)	(0.01)	(0.01)	-
Per share – diluted	**0.01**	-	(0.01)	(0.01)	(0.03)	(0.01)	(0.01)	-
Net cash used in operating activities (3)	**(396)**	422	86	(712)	(50)	(58)	(13)	(13)
Per share – basic	**-**	-	-	(0.01)	(0.01)	(0.01)	-	-
Per share – diluted	**-**	-	-	(0.01)	(0.01)	(0.01)	-	-
Total assets	**368,462**	349,853	301,445	180,358	26,789	6,601	6,652	3,405
Net working capital (Net debt) (4)	**81,138**	116,305	127,261	71,732	6,344	1,191	1,466	(101)

(1) *The diluted number of shares is equivalent to the basic number of shares due to stock options, incentive shares and/or warrants being antidilutive as the Company has a net loss. Therefore, the diluted per share amounts for net loss and funds flow from operations are equivalent to the basic per share amounts.*

(2) *Funds flow from operations should not be considered an alternative to, or more meaningful than, net cash used in operating activities as determined in accordance with International Financial Reporting Standards ("IFRS") as an indicator of TORC's performance. Funds flow from operations represents net cash used in operating activities prior to changes in non-cash working capital. TORC also presents funds flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share.*

(3) *Net cash used in operating activities is determined in accordance with IFRS and includes changes in non-cash working capital.*

(4) *Net working capital is calculated as current assets less current liabilities and non-current deferred lease incentives.*

MANAGEMENT'S STATEMENT OF RESPONSIBILITY

The accompanying consolidated financial statements of TORC Oil & Gas Ltd. were prepared by and are the responsibility of management. They have been prepared in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and include certain assessments that reflect management's best estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the consolidated financial statements are presented fairly in all material respects. The financial information contained elsewhere in Management's Discussion and Analysis has been reviewed to ensure consistency with the consolidated financial statements.

Management has developed and maintains systems of internal controls designed to provide reasonable assurance that all transactions are properly recorded in the Company's financial records, that procedures and policies are adhered to, that the consolidated financial statements realistically report the Company's operating and financial results, and that assets are safeguarded from unauthorized use. Management believes that this system of internal controls has operated effectively for the year ended December 31, 2011.

KPMG LLP, an independent firm of chartered accountants, has been engaged to examine the consolidated financial statements in accordance with Canadian generally accepted auditing standards and to provide an independent auditors' report thereon.

The Board of Directors, through its Audit Committee, has reviewed the consolidated financial statements including notes thereto with management and KPMG LLP. The Audit Committee is composed of three unrelated and independent members of the Board of Directors and meets quarterly with the financial officers of the Company. KPMG LLP has access to the Audit Committee to review the planning and scope of testing and to discuss the results of their audit work. On the recommendation of the Audit Committee, the accompanying consolidated financial statements have been approved by the Board of Directors.

(signed)

Brett Herman
President and
Chief Executive Officer

(signed)

Jason Zabinsky
Vice President, Finance and
Chief Financial Officer

Calgary, Canada
March 20, 2012

AUDITORS' REPORT TO THE SHAREHOLDERS

To the shareholders of TORC Oil & Gas Ltd.

We have audited the accompanying consolidated financial statements of TORC Oil & Gas Ltd., which comprise the consolidated statements of financial position as at December 31, 2011 and December 31, 2010, the consolidated statements of comprehensive income, changes in equity, and cash flows for the year ended December 31, 2011 and for the period from incorporation on March 23, 2010 to December 31, 2010, and notes, comprising 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 these 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 our 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, we consider 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 consolidated financial position of TORC Oil & Gas Ltd. as at December 31, 2011 and December 31, 2010, and its consolidated financial performance and its consolidated cash flows for the year ended December 31, 2011 and for the period from incorporation on March 23, 2010 to December 31, 2010 in accordance with International Financial Reporting Standards.

(signed)

KPMG LLP
Chartered Accountants

Calgary, Canada
March 20, 2012

TORC Oil & Gas Ltd.

Consolidated Statement of Financial Position
(in $000's of Canadian dollars)

	Note	As at December 31, 2011	As at December 31, 2010
Assets			
Cash		$ 110,747	$ 6,666
Trade and other receivables	7	4,062	25
Deposits and prepaid expenses		305	140
Total current assets		115,114	6,831
Exploration and evaluation assets	12	120,708	19,836
Property, plant and equipment	13	132,640	-
Deferred tax asset	15	-	122
Total non-current assets		253,348	19,958
Total assets		$ 368,462	$ 26,789
Liabilities			
Trade and other payables		$ 33,166	$ 488
Deferred lease incentives	19	177	-
Total current liabilities		33,343	488
Flow-through shares	19	3,733	700
Deferred lease incentives	19	633	-
Decommissioning obligations	14	877	-
Deferred tax liability	15	1,958	-
Total non-current liabilities		7,201	700
Total liabilities		$ 40,544	$ 1,188
Equity			
Share capital	16	$ 329,836	$ 25,914
Contributed surplus		3,106	44
Deficit		(5,024)	(357)
Total equity		327,918	25,601
Total liabilities and equity		$ 368,462	$ 26,789

Commitments (note 19)

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board

(signed)

Raymond Chan
Director

(signed)

Brett Herman
Director

TORC Oil & Gas Ltd.

Consolidated Statement of Loss and Comprehensive Loss
(in $000's of Canadian dollars, except per share amounts)

	Note		Year ended Dec 31, 2011		Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Revenues					
Petroleum and natural gas sales		$	3,369	$	-
Royalties			(293)		-
			3,076		-
Expenses					
Operating			405		-
Transportation			248		-
General and administrative	8		2,711		441
Finance costs (income)	10		(807)		-
Stock-based compensation	17		1,398		18
Depletion and depreciation			1,979		-
			5,934		459
Loss before income taxes			(2,858)		(459)
Deferred income tax (recovery)	15		1,809		(102)
Loss and comprehensive loss		$	(4,667)	$	(357)
Loss per share:					
Basic	18	$	(0.05)	$	(0.04)
Diluted	18	$	(0.05)	$	(0.04)

See accompanying notes to the consolidated financial statements.

TORC Oil & Gas Ltd.

Consolidated Statement of Changes in Equity
(in $000's of Canadian dollars, unless otherwise noted)

	Number of common shares	Number of warrants	Share capital	Contributed surplus	Retained earnings (deficit)	Total equity
Balance at incorporation, March 23, 2010	-	-	$ -	$ -	$ -	$ -
Issue of common shares	27,049	-	26,659	-	-	26,659
Flow-through share liability	-	-	(700)	-	-	(700)
Issue of warrants	-	20,000	-	-	-	-
Share issue costs, net of tax of $0.02 million	-	-	(45)	-	-	(45)
Stock-based compensation	-	-	-	44	-	44
Loss for the period	-	-	-	-	(357)	(357)
Balance at December 31, 2010	27,049	20,000	25,914	44	(357)	25,601
Issue of common shares	93,256	-	320,679	-	-	320,679
Issued on exercise of stock options	1,128	-	1,128	-	-	1,128
Flow-through share liability	-	-	(6,961)	-	-	(6,961)
Share issue costs, net of tax of $3.7 million	-	-	(10,968)	-	-	(10,968)
Stock-based compensation	-	-	-	3,106	-	3,106
Transfer of stock-based compensation on exercise of stock options	-	-	44	(44)	-	-
Loss for the year	-	-	-	-	(4,667)	(4,667)
Balance at December 31, 2011	**121,433**	**20,000**	**$ 329,836**	**$ 3,106**	**$ (5,024)**	**$ 327,918**

See accompanying notes to the consolidated financial statements.

TORC Oil & Gas Ltd.
Consolidated Statement of Cash Flows
(in $000's of Canadian dollars)

	Note	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Cash flows from operating activities:			
Loss for the period		$ (4,667)	$ (357)
Stock-based compensation		1,398	18
Depletion and depreciation		1,979	-
Deferred income tax recovery		1,809	(102)
Accretion on decommissioning obligations	10	2	-
Change in non-cash working capital	11	(1,121)	308
Net cash used in operating activities		(600)	(133)
Cash flows from investing activities:			
Additions to exploration and evaluation assets		(199,820)	(19,811)
Additions to property, plant and equipment		(10,376)	-
Change in non-cash working capital	11	30,397	15
Net cash used in investing activities		(179,799)	(19,796)
Cash flows from financing activities:			
Proceeds from issue of share capital		299,095	26,659
Share issue costs		(14,625)	(64)
Change in non-cash working capital	11	10	-
Net cash from financing activities		284,480	26,595
Change in cash		104,081	6,666
Cash, beginning of period		6,666	-
Cash, end of period		$ 110,747	$ 6,666

See accompanying notes to the consolidated financial statements.

TORC Oil & Gas Ltd.

Notes to the Consolidated Financial Statements
As at December 31, 2011 and 2010, for the year ended December 31, 2011 and for the period from incorporation on March 23, 2010 to December 31, 2010
(in $000's of Canadian dollars, unless otherwise noted)

1. Reporting entity

TORC Oil & Gas Ltd. (the “Company” or "TORC") was incorporated pursuant to the Business Corporations Act (Alberta) on March 23, 2010 as 1525893 Alberta Ltd. The Company's name was changed to TORC Oil & Gas Ltd. on December 17, 2010. The Company's principal business activity is the exploration for and production of petroleum and natural gas in the Western Canadian Sedimentary Basin.

The Company's principle place of business is located at Suite 1800, Eighth Avenue Place, 525 - 8th Avenue SW, Calgary, Alberta, Canada T2P 1G1.

2. Basis of preparation

Certain prior period figures have been reclassified to conform to the current year’s financial statement presentation.

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and were authorized for issue by the Board of Directors on March 20, 2012.

(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis.

(c) Functional and presentation currency

The consolidated financial statements are presented in Canadian dollars, which is the Company’s functional currency.

(d) Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Reserve estimates for crude oil, natural gas and natural gas liquids impact a number of the areas referred to above; in particular, the decision to transfer costs from exploration and evaluation assets to property, plant and equipment, impairment calculations and the calculation of depletion.

3. Principles of consolidation

As at December 31, 2011, the consolidated financial statements include the accounts of TORC and its wholly owned subsidiaries.

Operating expenses in the statement of income and comprehensive income are presented as a combination of function and nature to conform with industry practice. Depletion and depreciation is presented on a separate line by its nature, while operating expenses and general and administrative expenses are presented on a functional basis. Significant expenses such as key management personnel's short-term employee benefits and stock-based compensation are presented by their nature in the notes to the consolidated financial statements.

TORC Oil & Gas Ltd.

Notes to the Consolidated Financial Statements
As at December 31, 2011 and 2010, for the year ended December 31, 2011 and for the period from incorporation on March 23, 2010 to December 31, 2010
(in $000's of Canadian dollars, unless otherwise noted)

4. Significant accounting policies

The accounting policies set out below have been applied consistently to the period presented in the financial statements and reflect those significant policies that are expected to be relevant in future periods.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets and liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately as a gain in the statement of income and comprehensive income.

(ii) Jointly controlled operations and jointly controlled assets

Many of the Company's oil and natural gas activities involve jointly controlled assets. The financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

(iii) Transactions eliminated on consolidation

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing consolidated financial statements.

(b) Foreign currency

Transactions in foreign currencies are translated to Canadian dollars at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the period end exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to Canadian dollars at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on translation are recognized in the statement of income and comprehensive income.

(c) Financial instruments

Non-derivative financial instruments

Non-derivative financial instruments are comprised of cash and cash equivalents including bank overdrafts, trade and other receivables, trade and other payables and loans and borrowings. Non-derivative financial instruments are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

Cash and cash equivalents:

Cash and short term deposits on the statement of financial position comprise cash at banks and on hand and short term deposits with an original maturity of three months or less.

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents defined above, net of outstanding bank overdrafts.

Financial assets at fair value through the statement of income and comprehensive income:

Financial assets at fair value through the statement of income and comprehensive income includes financial assets held for trading and financial assets designated upon initial recognition as at fair value through the statement of income and comprehensive income (such as marketable securities).

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments or a financial guarantee contract.

Gains or losses on investments held for trading are recognized in the statement of income and comprehensive income.

Other:

Other non-derivative financial instruments, such as loans and borrowings, trade and other receivables and trade and other payables, are measured at amortized cost using the effective interest method, less any impairment losses.

Derivative financial instruments

The Company may enter into certain financial derivative contracts (often known as "hedges") in order to manage the exposure to market risks from fluctuations in commodity prices, interest rates and foreign exchange rates. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, and thus not applied hedge accounting, even though the Company considers all derivative contracts to be economic hedges. As a result, all financial derivative contracts are recorded on the statement of financial position at fair value, with changes in fair value recorded in the statement of income and comprehensive income. Related transaction costs such as trading commissions are recognized in the statement of income and comprehensive income when incurred.

Forward physical delivery and sales contracts of oil and natural gas products are entered into under normal course of business and therefore not recorded at fair value on the statement of financial position. These physical delivery contracts are not considered to be derivative financial instruments or hedges. Settlements on these physical delivery contracts are recognized in oil and natural gas revenue on the statement of income and comprehensive income.

Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares, warrants and share options are recognized as a deduction from equity, net of any tax effects.

(d) Exploration and evaluation assets ("E&E")

Costs incurred prior to the ownership of licenses and rights to drill on properties are expensed in the statement of income and comprehensive income as incurred, if the related licenses and rights are not subsequently acquired.

The costs incurred to acquire licenses and rights to drill, including seismic costs, and the subsequent drilling and completing costs related to these licenses (including employee remuneration, materials and fuel used, rig costs and payments made to contractors) are capitalized as E&E assets until the drilling of the well is complete and the results have been evaluated.

E&E assets are accumulated in cost centers pending the determination of technical feasibility and commercial viability of the drilling project. Technical feasibility and commercial viability is considered to be achieved when proven reserves are determined to exist. Upon determination of proven reserves, the related E&E assets are reclassified to a different long-term asset category, Drilling and Production ("D&P") assets within Property, Plant and Equipment ("PP&E"), where the assets may be subject to depletion expense.

E&E assets are measured at cost less accumulated impairment losses and not subject to depletion expense until after these assets are reclassified to PP&E. Any gain or loss arising on disposal of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the statement of income and comprehensive income in the period in which the item is disposed.

As facts and circumstances suggest, E&E assets are tested for impairment. The Company compares the carrying amount of its total E&E assets to the assets' recoverable amount, which, for E&E assets, is generally the fair market value of undeveloped land at the time of impairment testing. In addition, E&E assets related to specific technically feasible and commercially viable cost centers are tested for impairment if and when they are reclassified to PP&E.

Impairment losses recognized in prior periods are assessed as facts and circumstances suggest to evaluate if those losses have decreased or no longer exist. If those impairment losses have decreased or no longer exist (recovered), they are reversed accordingly. Previously recognized impairment losses may be recovered in future reporting periods due to changes in estimates used to determine the recoverable amount. An impairment loss recovery is recorded only to the extent that the E&E asset's carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognized. Impairment losses and recoveries are recorded in the statement of income and comprehensive income.

(e) Property, plant and equipment ("PP&E")

There are two categories of PP&E: Drilling and Production ("D&P") assets and Other PP&E assets.

D&P assets include capital costs (i) related to drilling projects where the drilling location is already determined to hold proven reserves, (ii) that have been reclassified from E&E assets because proven reserves have been determined, and (iii) incurred to improve an already technically feasible and commercially viable well.

Other PP&E typically includes furniture, fixtures, leasehold improvements and office equipment.

For statement of financial position presentation, both D&P assets and Other PP&E are included in the PP&E category.

(i) Recognition and measurement

PP&E is measured at cost less accumulated depletion and depreciation and accumulated impairment losses. For the purposes of depletion and depreciation, when significant parts of PP&E have different useful lives, they are accounted for separately so that depletion and depreciation rates appropriately reflect useful lives.

Gains and losses on disposal of PP&E, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the PP&E sold, and are recognized on a net basis within “other income” or “other expenses” in the statement of income and comprehensive income.

For the purposes of impairment testing, PP&E is divided and grouped into the smallest group of assets that generate independent cash inflows from continuing use. These groups of assets are called cash generating units ("CGU's").

Impairment testing of PP&E is performed as facts and circumstances suggest by comparing the carrying amount of each CGU to each CGU's recoverable amount. The recoverable amount of a CGU is the greater of (i) its value in use, and (ii) its fair value less selling costs. In calculating value in use for D&P assets, the estimated future cash flows from the production of proven and probable reserves are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For D&P assets, the value of proven and probable reserves from an internally generated or independent reserve report is often the basis for determining value in use.

Impairment losses recognized in prior periods are assessed at each reporting date to evaluate if those losses have decreased or no longer exist. If those impairment losses have decreased or no longer exist (recovered), they are reversed accordingly. Previously recognized impairment losses may be recovered in future reporting periods due to changes in estimates used to determine the recoverable amount. An impairment loss recovery is recorded only to the extent that the PP&E carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized. Impairment losses and recoveries are recorded in the statement of income and comprehensive income.

(ii) Proven and probable reserves

Proven and probable reserves represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50 percent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proven and probable and a 50 percent statistical probability that it will be less. These are initially estimated internally by the Company; however at least annually, reserves are evaluated by independent reserve evaluators.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

(iii) Subsequent costs

Subsequent costs are capital costs incurred to improve an existing D&P asset (such as a well) that is technically feasible and commercially viable. These costs are capitalized as D&P assets only if they increase the future economic benefits of the well. All other expenditures are expensed in the statement of income and comprehensive income as incurred. These improvement costs include capital costs of further developing proven reserves or enhancing production. The costs of routine maintenance of D&P assets are recognized in the statement of income and comprehensive income as incurred.

(iv) Depletion and depreciation

The net carrying value of D&P assets is depleted using the unit-of-production method by calculating the ratio of production in the period to the related proven and probable reserves. The carrying value to be depleted includes estimated future development costs necessary to produce proven and probable reserves. Future development costs are estimated by considering the level of development required to produce the proven and probable reserves and are reviewed by independent reserve engineers at least annually.

For Other PP&E, depreciation is recognized in the statement of income and comprehensive income on a straight-line basis over their estimated useful lives. Finance lease assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(f) Goodwill

The Company records goodwill relating to corporate acquisitions when the purchase price exceeds the fair value of the net identifiable assets and liabilities acquired by the Company. When goodwill is negative, it is recognized immediately in the statement of income and comprehensive income. The goodwill balance is assessed for impairment annually or as events occur that could result in an impairment. Goodwill is measured at cost less accumulated impairment losses.

For the purposes of impairment testing, goodwill is allocated to CGU's that are expected to economically benefit from the business combination from which the goodwill arose. An impairment loss is recognized if the carrying amount of a CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the statement of income and comprehensive income. Impairment losses identified in a CGU are first charged against any goodwill related to that CGU, with any remaining impairment losses charged against E&E or PP&E assets remaining in that CGU. Impairment losses of goodwill cannot be reversed.

(g) Leased assets

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases and capitalized as PP&E. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Payments made under operating leases are recognized in the statement of income and comprehensive income on a straight-line basis over the term of the lease and not recognized as a liability on the Company's statement of financial position. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(h) Stock-based compensation

The grant date fair value of stock-based compensation, such as stock options granted to employees, is recognized as stock-based compensation expense, with a corresponding increase in contributed surplus over the vesting period. The inputs used in the calculation of the fair value of stock-based compensation are estimated on the grant date and are reviewed at each reporting period. Any changes to these inputs are reflected as a change in fair value.

(i) Flow-through shares

The Company may finance a portion of its exploration activities through the issuance of flow-through common shares. Under the terms of the flow-through share agreements, the resource expenditure deductions for income tax purposes are renounced to investors in accordance with the appropriate income tax legislation.

The proceeds from the sale of flow-through shares are allocated between the offering of shares and the sale of tax benefits. The allocation is made based on the difference between the fair market price of the existing shares and the amount the investor pays for the flow-through shares (given no other differences between the securities). A flow-through share liability is recognized for this difference. On a pro-rata basis, the previously recorded flow-through share liability is reversed and a corresponding deferred tax liability (equal to the Company's effective tax rate multiplied by the flow-through commitment) is recognized as qualifying expenditures are incurred. Any difference between the reversal of the flow-through share liability and corresponding deferred tax liability is recognized as deferred tax expense in the statement of income and comprehensive income.

(j) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

Examples of provisions include dismantling, decommissioning and site disturbance remediation activities, and anticipated losses from lawsuits. Provision is made for the estimated cost of these activities and capitalized in the relevant asset category.

Decommissioning obligations

Decommissioning obligations (also called asset retirement obligations) are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the statement of financial position date. Subsequent to initial measurement, the obligation is adjusted at the end of each reporting period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. Any changes to such estimates are applied prospectively. The increase in the provision due to the passage of time, known as accretion, is recognized in the statement of income and comprehensive income as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(k) Revenue

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product are transferred to the buyer which is usually when legal title passes to the external party. This is generally at the time product enters a third party pipeline or facility. Revenue is measured net of discounts, customs duties and royalties. With respect to the latter, the entity is acting as a collection agent on behalf of others.

Tariffs and tolls charged to other entities for use of pipelines and facilities owned by the Company are recognized as revenue as they accrue in accordance with the terms of the service or tariff and tolling agreements.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

(l) Finance income and costs

Finance costs comprise of interest expense on borrowings, accretion of the discount on decommissioning obligations, and impairment losses recognized on financial assets.

Interest income is recognized as it accrues in the statement of income and comprehensive income, using the effective interest method.

(m) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the statement of income and comprehensive income except to the extent that it relates to items recognized directly in equity, such as share issue costs, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted at the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred 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.

(n) Earnings per share

Basic earnings per share is calculated by dividing the net income or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the net income or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

5. Changes in accounting policies

On January 1, 2013 (except otherwise noted), the following accounting standards and amendments, issued by the International Accounting Standards Board ("IASB"), may become applicable. The Company has yet to assess the full impact or relevance of these accounting standards and amendments on its consolidated financial statements.

IFRS 9 "Financial Instruments"

IFRS 9 will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 establishes two categories for measuring financial assets and liabilities: i) amortized cost, and ii) fair value. These two categories eliminate the existing IAS 39 categories of held-to-maturity, available-for-sale, and loans and receivables. IFRS 9 is not effective until January 1, 2015.

IFRS 10 "Consolidated Financial Statements"

IFRS 10 establishes a new approach to determining which investees should be consolidated. Issued in May 2011 by the IASB, IFRS 10 will replace IAS 27 Consolidated and Separate Financial Statements. IFRS 10 uses control as the single determination for consolidation of an entity.

IFRS 11 "Joint Arrangements"

IFRS 11 will replace IAS 31 Interest in Joint Ventures and establishes two categories of joint arrangements: i) joint operations, and ii) joint ventures. IFRS 11 further describes the criteria necessary to classify a joint arrangement as either a joint operation or a joint venture. IFRS 11 requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under existing IAS 31, joint ventures may be proportionately consolidated.

IFRS 12 "Disclosure of Interests in Other Entities"

IFRS 12 establishes the required disclosures for interests in joint arrangements and subsidiaries. The new disclosures provide information that is intended to assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in joint arrangements and subsidiaries.

IFRS 13 "Fair Value Measurement"

IFRS 13 replaces the fair value measurement guidance currently dispersed across various IFRS standards with a single definition of fair value measurement. IFRS 13 does not change when an entity is required to use fair value, rather, it describes how to measure fair value when it is required or permitted.

6. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

Exploration and evaluation assets, and property, plant and equipment

The fair value of exploration and evaluation assets and property, plant and equipment recognized in a business combination, is based on market value. The market value of E&E assets and PP&E is the estimated amount for which E&E assets and PP&E could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests included in E&E assets and PP&E is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on internally and externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

Cash and cash equivalents, bank overdrafts, trade and other receivables, trade and other payables, and loans and borrowings

The fair value of cash and cash equivalents, bank overdrafts, trade and other receivables, trade and other payables, and loans and borrowings is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2011, the fair value of these balances approximated their carrying value due to their short term to maturity.

Derivatives

The fair value of financial forward contracts and swaps is determined by discounting the difference between the contracted prices and published forward price curves as at the statement of financial position date, using the remaining contracted oil and natural gas volumes and a risk-free interest rate. The fair value of costless collars is based on option models that use published information with respect to volatility, prices and interest rates.

Stock-based compensation

The fair value of stock-based compensation, such as employee stock options, is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the option, expected volatility, weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, forfeiture rate and the risk-free interest rate.

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7. Financial risk management

(a) Overview

The Company's activities expose it to a variety of financial risks such as credit risk, liquidity risk and market risk that arise as a result of its exploration, development, production and financing activities.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors oversees management's establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls and to monitor risks and market conditions.

(b) Credit risk

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

With respect to trade and other receivables, the Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

Receivables from petroleum and natural gas marketers are collected on the 25th day of each month following production. The Company's policy to mitigate credit risk associated with these balances is to establish relationships with credit-worthy marketers, as well as to carefully assess the extent of credit granted to these parties.

Joint venture receivables are normally collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risks exist with joint venture partners as disagreements occasionally arise, increasing the risk of non-collection.

The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners. However, the Company does have the ability to withhold production from joint venture partners in the event of non-payment, as well as requiring prepayment (cash calls) for significant expenditures.

The Company does not anticipate any default as it transacts with credit-worthy customers and management does not expect any losses from non-performance by these customers. As such, a provision for doubtful accounts has not been recorded at December 31, 2011.

(in $000's of Canadian dollars, unless otherwise noted)

The maximum exposure to credit risk for trade and other receivables at the reporting date by type of customer was:

	December 31, 2011	December 31, 2010
Petroleum and natural gas marketing companies	**$ 1,793**	$ -
Joint venture partners	**996**	-
Other parties [(1)]	**1,213**	25
Bank [(2)]	**60**	-
Total trade and other receivables	**$ 4,062**	$ 25

[(1)] Other parties is comprised of goods and services tax ("GST") receivable from the federal government.

[(2)] Bank is comprised of short-term deposit interest receivable from the Company's bank.

As at December 31, 2011, the Company's trade and other receivables are aged as follows:

	December 31, 2011	December 31, 2010
Current (less than 90 days)	**$ 4,015**	$ 13
Past due (greater than 90 days)	**47**	12
Total	**$ 4,062**	$ 25

(c) Liquidity risk

Liquidity risk relates to the risk that the Company will encounter difficulty in meeting its obligations associated with financial liabilities. The financial liabilities on the statement of financial position consist of trade and other payables. The Company anticipates it will continue to have adequate liquidity to fund its financial liabilities. The Company has had no defaults or breaches on its financial liabilities.

(d) Market risk

Market risk is the risk that changes in market prices relating to currency, commodity prices and interest rates will affect the Company's net earnings, future cash flows, the value of financial instruments, or the fair value of its assets and liabilities.

Although the Company generally does not sell or transact in foreign currency, the United States dollar influences the price of petroleum and natural gas sold in Canada. Furthermore, exchange rate fluctuations can affect the fair value and cash flow from derivative contracts.

Commodity prices for crude oil, natural gas liquids and natural gas are also impacted by political events, meteorological conditions and changes in supply and demand. The Company may enter into commodity derivative contracts that provide downside price protection in order to provide some stability of cash flows for capital spending and planning purposes. The Company's risk management activities are conducted pursuant to its risk management policies approved by the Board of Directors. As at December 31, 2011, the Company had not entered into any derivative contracts.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in interest rates. As at December 31, 2011, the Company had no bank debt.

(in $000's of Canadian dollars, unless otherwise noted)

(e) Capital management

The Company's policy is to maintain a strong capital base in order to maintain financial flexibility and to sustain the future development of the business. The Company manages its capital structure and makes adjustments relative to changes in economic conditions and the Company's risk profile. In order to maintain the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels. The Company monitors its working capital in order to optimize capital and operating efficiency.

Credit facility

On March 20, 2012, the Company had available a $50.0 million credit facility arranged in February 2011 with a major Canadian bank. The credit facility provides that advances may be made by way of direct advances, bankers acceptances, or standby letters of credit/guarantees. The banker's acceptances and standby letters of credit/guarantees bear interest at the applicable banker's acceptance rate, plus a customary stamping fee. Direct advances bear interest at the bank's prime lending rate for Canadian dollar advances and at the bank's U.S. base rate for U.S. dollar advances. The credit facility is convertible to a borrowing base facility based on the Company's proven reserves. There are no standby fees on this credit facility.

The amount available under the facility depends on the amount of cash and cash equivalents held, up to $25.0 million, and an additional borrowing base amount of up to $25.0 million for the purpose of buying assets with proven reserves. The amount available under the facility is reduced by outstanding letters of credit, which totaled $2.0 million as at December 31, 2011 (December 31, 2010 - $nil). As a result, the amount available under the facility at December 31, 2011 was $23.0 million. The credit facility is secured by a fixed and floating charge debenture on the assets of the Company. The borrowing base is subject to semi-annual review by the bank.

8. General and administrative expenses

	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Consulting and professional	**$ 536**	$ 144
Office and personnel	**5,231**	410
Transaction related	**-**	191
	5,767	745
Recoveries	**(641)**	-
Capitalized general and administrative expenses	**(2,415)**	(304)
	$ 2,711	$ 441

Recoveries refers to those G&A expenditures which under industry practice are reclassified to operating expenses, exploration and evaluation assets, or property, plant and equipment.

Capitalized general and administrative expenses are those G&A expenditures which are directly attributable to the acquisition or exploration activities of the Company, and are therefore reclassified to exploration and evaluation assets, or property, plant and equipment.

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9. Key management personnel compensation

	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Short-term employee benefits	**$ 1,415**	$ 285
Stock-based compensation	**1,808**	44
	3,223	329
Capitalized portion of total compensation	**(1,773)**	(197)
	$ 1,450	$ 132

Key management personnel includes the officers and directors of the Company.

Short-term employee benefits and stock-based compensation include both the capitalized and non-capitalized portion of these expenditures.

10. Finance costs (income)

	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Interest income	**$ (851)**	$ -
Financing charges	**42**	-
	(809)	-
Accretion on decommissioning obligations	**2**	-
	$ (807)	$ -

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11. Supplemental cash flow information

Changes in non-cash working capital is comprised of:

	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Source/(use) of cash:		
Trade and other receivables	**$ (4,037)**	$ (25)
Deposits and prepaid expenses	**(165)**	(140)
Trade and other payables	**32,678**	488
Deferred lease incentives	**810**	-
	$ 29,286	$ 323
Related to operating activities	**$ (1,121)**	$ 308
Related to investing activities	**30,397**	15
Related to financing activities	**10**	-
	$ 29,286	$ 323

The following table summarizes interest and taxes paid/(received):

	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Interest paid/(received)	**$ (850)**	$ -
Taxes paid	**-**	-
	$ (850)	$ -

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12. Exploration and evaluation assets

Balance at incorporation, March 23, 2010	$	-
Property acquisitions		19,505
Capital expenditures		331
Balance at December 31, 2010	$	19,836
Property acquisitions		158,454
Property dispositions		(433)
Capital expenditures		66,279
Transferred to property, plant and equipment		(123,428)
Balance at December 31, 2011	**$**	**120,708**

Exploration and evaluation assets ("E&E assets") consist of the Company's exploration projects, principally undeveloped land, which are pending the determination of proven reserves. Property acquisitions and capital expenditures represent the Company's share of costs incurred on E&E assets during the period.

Certain property acquisitions during the year ended December 31, 2011 were funded by the issuance of the Company's common shares ("Common Shares") as described in note 16, totaling $22.7 million.

Based on the facts and circumstances in place at December 31, 2011, there were no indications of impairment in the Company's exploration and evaluation assets. As a result, under IFRS, an impairment test for exploration and evaluation assets was not required.

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13. Property, plant and equipment

Cost:		
Balance on incorporation, March 23, 2010	$	-
Capital expenditures		-
Balance at December 31, 2010		-
Capital expenditures		10,376
Change in decommissioning obligations		815
Transferred from exploration and evaluation assets		123,428
Balance at December 31, 2011	**$**	**134,619**
Accumulated depletion and depreciation:		
Balance on incorporation, March 23, 2010	$	-
Depletion and depreciation for the period		-
Balance at December 31, 2010		-
Depletion and depreciation for the period		1,979
Balance at December 31, 2011	**$**	**1,979**
Carrying value:		
As at December 31, 2010	$	-
As at December 31, 2011	**$**	**132,640**

Included in the carrying value of property, plant and equipment at December 31, 2011 is office equipment of $0.3 million, net of depreciation of $0.07 million (at December 31, 2010: $nil).

At December 31, 2011, the Company had undepletable property, plant and equipment of $95.5 million which largely related to undeveloped land. Estimated future development costs of $0.4 million were included in the depletion calculation.

Based on the facts and circumstances in place at December 31, 2011, there were no indications of impairment in the Company's property, plant and equipment. As a result, under IFRS, an impairment test for property, plant and equipment was not required.

14. Decommissioning obligations

		Year ended Dec 31, 2011		Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Balance, beginning of period	**$**	**-**	$	-
Obligations incurred		**804**		-
Obligations acquired		**60**		-
Change in discount rate		**11**		-
Accretion		**2**		-
Balance, end of period	**$**	**877**	$	-

The total future decommissioning obligations are based on the Company's net ownership in wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company has estimated an undiscounted total future liability of $0.9 million as at December 31, 2011 (at December 31, 2010: $nil) to be incurred over the next 25 years. The Company's risk-free rate of 2.4 percent and an inflation rate of 2.0 percent per annum were used to calculate the net present value of the decommissioning obligations. Actual costs may differ from estimated costs due to changes in laws and regulations, timing of costs, changes in technology and market conditions.

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15. Taxes

Tax expense/(recovery)

The combined provision for taxes in the statement of loss and comprehensive loss reflects an effective tax rate which differs from the expected statutory rate. The reasons for the difference are as follows:

		Year ended Dec 31, 2011		Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Loss before taxes	**$**	**(2,858)**	$	(459)
Statutory income tax rate		**26.5%**		28.0%
Expected income tax (recovery)		**(757)**		(129)
Add (deduct):				
Non-deductible stock-based compensation		**370**		12
Flow-through share liability		**2,164**		-
Rate adjustments		**23**		14
Other non-deductible items		**9**		-
Other		**-**		1
Deferred income tax (recovery)	**$**	**1,809**	$	(102)

As a result of the Federal statutory income tax rate decreasing from 18.0% in 2010 to 16.5% in 2011, the combined Federal and Provincial statutory income tax rate decreased from 28.0% in 2010 to 26.5% in 2011.

Deferred tax liability/(asset)

The components of the deferred tax liability/(asset) are as follows:

		As at December 31, 2011		As at December 31, 2010
E&E and PP&E	**$**	**14,112**	$	-
Decommissioning obligations		**(219)**		-
Loss carryforwards		**(8,948)**		(102)
Share issue costs		**(2,987)**		(20)
	$	**1,958**	$	(122)

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The following table summarizes the continuity of the deferred tax liability/(asset):

	As at incorporation, Mar 23, 2010	Recognized in profit or loss	Recognized in equity	Flow-through share premium	As at Dec 31, 2010
E&E and PP&E	$ -	$ -	$ -	$ -	$ -
Loss carryforwards	-	(102)	-	-	(102)
Share issue costs	-	-	(20)	-	(20)
	$ -	$ (102)	$ (20)	$ -	$ (122)

	As at Jan 1, 2011	Recognized in profit or loss	Recognized in equity	Flow-through share premium	As at Dec 31, 2011
E&E and PP&E	$ -	$ 10,185	$ -	$ 3,927	$ 14,112
Decommissioning obligations	-	(219)	-	-	(219)
Loss carryforwards	(102)	(8,157)	(689)	-	(8,948)
Share issue costs	(20)	-	(2,967)	-	(2,987)
	(122)	1,809	(3,656)	3,927	1,958

As at December 31, 2011, the Company has tax deductions of approximately $225 million (2010: $20 million) available to shelter future taxable income:

As further described in note 19, at December 31, 2011, the Company has an obligation to incur $22.4 million of expenditures that qualify as flow-through share costs.

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16. Share capital

Share capital - authorized

At December 31, 2011, the Company was authorized to issue an unlimited number of Class A voting common shares, an unlimited number of Class B non-voting common shares and an unlimited number of preferred shares. The Company has not issued any Class B non-voting common shares nor any preferred shares.

Share capital - issued and outstanding

On December 17, 2010, the Company closed a private placement to insiders and service providers whereby 5.0 million units were issued at $4.00 per unit, for gross proceeds of $20.0 million.

On January 6, 2011, stock options granted in December 2010 were exercised resulting in the issuance of 1,127,840 Common Shares for $1.00 per Common Share for gross proceeds of $1.1 million.

On January 6, 2011, the Company completed a private placement equity financing by issuing 4,000,000 Common Shares at $1.50 per Common Share for gross proceeds of $6.0 million, before share issue costs.

On February 3, 2011, the Company completed a private placement equity financing by issuing 41,734,000 Common Shares at $3.00 per Common Share for gross proceeds of $125.2 million, before share issue costs.

On February 18, 2011, as part of the consideration paid to acquire exploration and evaluation assets, the Company issued 7,570,979 Common Shares valued at a deemed price of $3.00 per share.

On June 14, 2011, the Company completed a private placement equity financing by issuing 31,250,000 Common Shares at $4.00 per Common Share for gross proceeds of $125.0 million, before share issue costs.

On September 29, 2011, the Company completed a private placement equity financing by issuing 8,701,000 Common Shares on a flow-through basis at $4.80 per Common Share for gross proceeds of $41.8 million, before share issue costs.

The following table summarizes the changes in share capital:

	Number of shares		Amount
Balance at incorporation, March 23, 2010	-	$	-
Issue of Common Shares	27,049		26,659
Flow-through share liability	-		(700)
Share issue costs, net of tax of $0.02 million	-		(45)
Balance at December 31, 2010	27,049	$	25,914
Issue of Common Shares	93,256		320,679
Issued on exercise of stock options	1,128		1,128
Transfer of stock-based compensation on exercise	-		44
Flow-through share liability	-		(6,961)
Share issue costs, net of tax of $3.7 million	-		(10,968)
Balance at December 31, 2011	**121,433**	**$**	**329,836**

(in $000's of Canadian dollars, unless otherwise noted)

Warrants

On December 17, 2010, the Company closed a private placement (the "Private Placement") to insiders and service providers whereby 5.0 million units ("Units") were issued at $4.00 per Unit, for gross proceeds of $20.0 million. Each Unit is comprised of three common shares, one common share issued on a flow-through basis (the "Flow-through Shares") and four common share purchase warrants ("Warrants"). Each Warrant entitles the holder to acquire one common share at a price of $1.25, subject to the following vesting conditions:

- one-third of the Warrants may be exercised after the Company's stock price (the "Stock Price") exceeds $2.00;
- one-third of the Warrants may be exercised after the Company's Stock Price exceeds $2.50;
- one-third of the Warrants may be exercised after the Company's Stock Price exceeds $3.00; and
- the Stock Price is defined as the weighted average price per share for the 20 consecutive trading days ending immediately before such date on the TSX Venture Exchange, or on any other Canadian stock exchange on which the Company's shares may be listed. If the Company's shares are not listed on a stock exchange, the Stock Price is defined as the value of the consideration issuable or payable per common share in the event of a capital reorganization.

At December 31, 2011, none of the Warrants were exercisable. The Warrants expire five years from the date of grant.

As a condition to the issuance of the Units (the "Escrow Condition"), the Company may repurchase the Units, excluding the Flow-through Shares, without the consent of the subscriber (the "Subscriber") in the event that the Subscriber ceases to be a service provider of the Company. The Company may repurchase the Units, excluding the Flow-through Shares for the lesser of $3.00 per Unit and the product of three multiplied by the five day weighted trading price of the Common Shares ending on the last trading day immediately prior to the Subscriber ceasing to be a service provider, if applicable. One third of the Units are released from this Escrow Condition after each of the 12th, 18th and 24th month from the date of issue.

17. Stock-based compensation

The Company has an employee stock option plan under which employees and directors are eligible to receive option grants (“Stock Options”) and Common Share incentives (“Incentive Shares”). The total aggregate amount of Stock Options and Incentive Shares that can be issued cannot exceed ten percent of the outstanding Common Shares. Stock Options granted under the plan have a term of five years to expiry and vest over three years.

The following table summarizes Stock Option activity:

(thousands, unless otherwise noted)	Number of Stock Options	Weighted average exercise price
Balance at incorporation, March 23, 2010	-	$ -
Granted	1,128	1.00
Forfeited	-	-
Exercised	-	-
Balance at December 31, 2010	1,128	$ 1.00
Granted	6,298	3.06
Forfeited	-	-
Exercised	(1,128)	1.00
Balance at December 31, 2011	**6,298**	**$ 3.06**
Exercisable at December 31, 2011	**-**	**$ -**

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The following table summarizes Stock Options outstanding and exercisable at December 31, 2011:

(thousands, unless otherwise noted)	Number outstanding	Number exercisable	Weighted average remaining term (years)
Exercise price:			
$3.00	5,934	-	4.3
$4.00	364	-	4.8
$3.00 to $4.00	6,298	-	4.3

The fair value of each Stock Option granted was estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Risk free interest rate	1.4%	2.0%
Expected life (years)	3.0	21 days
Expected volatility (%)	40.0%	40.0%
Forfeiture rate (%)	0.0%	0.0%

In December 2010, former management and shareholders were granted 1,127,840 stock options in the Company, exercisable at $1.00 per stock option (the estimated market price of the Company's common shares at the date of grant). These stock options were exercised in full on January 6, 2011, reflecting a stock option life of 21 days.

The following table summarizes Incentive Share activity:

(thousands)	Number of Incentive Shares
Balance at incorporation on March 23, 2010 and at December 31, 2010	-
Granted	900
Forfeited	-
Common shares issued upon vesting	-
Balance at December 31, 2011	**900**
Convertible into Common Shares at December 31, 2011	**-**

Incentive Shares are earned over three years from the date of grant. Upon being earned, the Incentive Shares are converted into Common Shares and issued from treasury at no cost to the Incentive Shareholder. The fair value of Incentive Shares is deemed to equal the stock price on the date of grant.

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As at December 31, 2011 and 2010, for the year ended December 31, 2011 and for the period from incorporation on March 23, 2010 to December 31, 2010
(in $000's of Canadian dollars, unless otherwise noted)

18. Earnings per share

Earnings per share amounts are calculated by dividing the net loss for the period attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period.

For the year ended December 31, 2011, the diluted number of shares is equivalent to the basic number of shares due to antidilutive stock options, incentive shares and warrants. Therefore, the diluted per share amounts for net loss and funds flow from operations are equivalent to the basic per share amounts.

	Year ended Dec 31, 2011	Period from incorporation on Mar 23, 2010 to Dec 31, 2010
Loss for the period	**$ (4,667)**	$ (357)
Weighted average number of Common Shares	**95,833,852**	8,109,071
Basic and diluted loss per Common Share	**$ (0.05)**	$ (0.04)

19. Commitments

Flow-through shares issued in December 2010

In December 2010, the Company issued 5,000,000 flow-through Shares at a price of $1.00 per share for gross proceeds of $5.0 million. As a result, the Company was required to incur qualifying resource expenditures amounting to $5.0 million before December 31, 2011. The qualifying expenditures were renounced to shareholders as at December 31, 2010. As at December 31, 2011, all qualifying resource expenditures have been incurred and as a result, there is no obligation remaining for this flow-through share issue.

A flow-through share liability of $700,000 was recorded at December 31, 2010, reflecting the fair value of the liability associated with these shares at that date. The flow-through share liability was reduced on a pro-rata basis as the Company incurred qualifying expenditures. As at December 31, 2011, there was no remaining flow-through share liability related to this flow-through share issue.

Flow-through shares issued in September 2011

In September 2011, the Company issued 8,701,000 flow-through shares at a price of $4.80 per share for gross proceeds of $41.8 million. As a result, the Company must incur qualifying resource expenditures amounting to $41.8 million before December 31, 2012. The qualifying expenditures were renounced to shareholders as at December 31, 2011. The obligation remaining for this flow-through share issue was $22.4 million as at December 31, 2011.

A flow-through share liability of $7.0 million was recorded at September 30, 2011, reflecting the fair value of the liability associated with these shares at that date. This flow-through share liability will be reduced on a pro-rata basis as the Company incurs qualifying expenditures. As at December 31, 2011, the remaining flow-through share liability was $3.7 million.

(in $000's of Canadian dollars, unless otherwise noted)

Operating lease commitment

(a) Deferred lease incentives

The Company has entered into a lease commitment for office space. The term of the lease is 64 months commencing April 1, 2011, totaling $5.8 million. Under the terms of the lease, the period from April 1, 2011 until December 31, 2011 does not require any payments. However, the total expenditure will be amortized over the full term. This will result in a liability being recorded and accumulated during the rent free period, which will then reverse and be amortized to income over the remaining term of the office space lease when payments are actually made. The short-term and long-term components of the deferred rent expense liability represent those portions of the accumulated liability that will be amortized within 12 months and beyond that, respectively.

(b) Future lease payments

Future minimum lease payments for the Company's office space as at December 31, 2011 are as follows:

2012	$	1,257
2013		1,257
2014		1,257
2015		1,257
2016		733
	$	5,761

Farm-in transactions

The Company has entered into a number of farm-in agreements with third parties to earn interests in additional prospective acreage. At December 31, 2011, the Company's required future commitments are estimated to be $24 million, which are expected to be completed by the end of 2013 and form part of the Company's on-going capital program.

CORPORATE INFORMATION

Directors

John Brussa (3)
Raymond Chan (1), (3)
Bruce Chernoff (1)
Brett Herman
Dave Johnson (2), (3)
Dale Shwed (1), (2)
Hank Swartout (2)

(1) Audit Committee
(2) Reserves Committee
(3) Compensation Committee

Officers

Brett Herman
President and
Chief Executive Officer

Jason Zabinsky
Vice President, Finance and
Chief Financial Officer

Filippo Angelini
Vice President and Controller

Eric Strachan
Vice President, Exploration

Jeremy Wallis
Vice President, Land

Mike Wihak
Vice President, Operations

James M. Pasieka
Corporate Secretary

Auditor
KPMG LLP

Bankers
BMO Bank of Montreal

Legal Counsel
Heenan Blaikie

Evaluation Engineers
Sproule Associates Limited

Registrar and Transfer Agent
Investors are encouraged to contact TORC's Transfer Agent for information regarding their security holdings:

Olympia Trust Company
Suite 2300, 125 Ninth Avenue SE Calgary, Alberta T2G 0P6
Telephone: (403) 261-0900
Facsimile: (403) 265-1455
www.olympiatrust.com

Head Office
Suite 1800, Eighth Avenue Place
525 - 8th Avenue SW
Calgary, Alberta T2P 1G1
Telephone: (403) 930-4120
Facsimile: (403) 930-4159
www.torcoil.com