

## **Brownstone Energy Inc.**

### **Management's Discussion and Analysis**

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**For the quarter ended: September 30, 2013**

**Date of report: November 28, 2013**

This management's discussion and analysis of the financial condition and results of operation ("MD&A") of Brownstone Energy Inc. ("Brownstone" or the "Company") should be read in conjunction with Brownstone's unaudited interim condensed consolidated financial statements ("interim consolidated statements") and notes thereto as at and for the three months ended September 30, 2013 and the annual consolidated financial statements as at and for the year ended June 30, 2013. The same accounting policies and methods of computation were followed in the preparation of the interim consolidated statements as were followed in the preparation and described in note 3 of the annual consolidated financial statements as at and for the year ended June 30, 2013, except for those described under the "Change in Accounting Policies" section elsewhere in this MD&A.

Unless indicated otherwise, all financial data in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). All dollar amounts in this MD&A are reported in Canadian dollars unless otherwise indicated.

#### **Caution Regarding Forward-Looking Information:**

Certain information contained in this MD&A constitutes forward-looking information, which is information relating to future events or the Company's future performance and which is inherently uncertain. All information other than statements of historical fact may be forward-looking information. Forward-looking information is often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar words or phrases (including negative variations) suggesting future outcomes or statements regarding an outlook. Forward-looking information contained in this MD&A includes, but is not limited to the Company's expectations regarding its exploration and development activities, including expectations regarding the timing, costs and results of seismic acquisition, drilling and other activities, and future production volumes and sales, receipt of regulatory and governmental approvals, the Company's future working capital requirements, including its ability to satisfy such requirements, the exposure of its financial instruments to various risks and its ability to manage those risks, the Company's ability to use tax resource pools and loss carry-forwards, fees to be incurred by foreign subsidiaries and changes in accounting policies.

Forward-looking information involves known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information. The Company believes the expectations reflected in the forward-looking information are reasonable but no assurance can be given that these expectations will prove to be correct and readers are cautioned not to place undue reliance on forward-looking information contained in this MD&A. Some of the risks and other factors which could cause results to differ materially from those expressed in the forward-looking information contained in this MD&A include, but are not limited to: risks relating

to oil and gas exploration activities generally, including the availability and cost of seismic, drilling and other equipment; our ability to complete our capital programs; geological, technical, drilling and processing problems, including the availability of equipment and access to properties; our ability to secure adequate transportation for our products; potential losses which would stem from any disruptions in production, including work stoppages or other labour difficulties, or disruptions in the transportation network on which we are reliant; potential delays or changes in plans with respect to exploration or development projects or capital expenditures; our ability and the ability of our partners to attract and retain the necessary labour required to explore and develop our projects; potential conflicting interests with our joint venture partners; our failure or the failure of the holder(s) of licenses or leases to meet specific requirements of such licenses or leases; the failure by counterparties to make payments or perform their operational or other obligations in compliance with the terms of contractual arrangements between us and such counterparties; adverse claims made in respect of our properties or assets; operating hazards and other difficulties inherent in the exploration for and production and sale of crude oil and natural gas; political and economic conditions in the countries in which our property interests are located; obtaining the necessary financing for operations, our ability to generate taxable income from operations, fluctuations in the value of our portfolio investments due to market conditions and/or company-specific factors, fluctuations in prices of commodities underlying our interests and portfolio investments, and other risks included elsewhere in this MD&A under the heading "Risks" and in the Company's public disclosure documents filed with certain Canadian securities regulatory authorities and available under the Company's profile at [www.sedar.com](http://www.sedar.com).

Readers are cautioned that the foregoing lists of factors are not exhaustive. Although the Company has attempted to identify important factors that could cause actual events and results to differ materially from those described in the forward-looking information, there may be other factors that cause events or results to differ from those intended, anticipated or estimated. The forward-looking information contained in this MD&A are made as of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as otherwise required by law. All of the forward-looking information contained in this MD&A is expressly qualified by this cautionary statement.

### **Nature of the Business:**

Brownstone Energy Inc. ("Brownstone" or the "Company") is a Canadian-based, energy-focused company with direct interests in oil and gas exploration projects in several countries, including offshore Israel and in the Llanos Basin, Colombia. Its common shares are publicly-traded on the TSX Venture Exchange ("TSXV") under the symbol "BWN" and on the OTCQX under the symbol "BWSOF".

### **Summary:**

- As at September 30, 2013, the Company has working capital of \$9,571,017 as compared to working capital of \$8,992,430 as at June 30, 2013, an increase of 6%, primarily due to the increase in the fair value of the Company's investment portfolio and the reclassification of restricted cash to current during the three months ended September 30, 2013.
- As at September 30, 2013, exploration and evaluation assets decreased by 4% to \$16,536,187 as compared to \$17,274,483 as at June 30, 2013. The decrease includes \$831,014 of revenue from the sale of oil generated during long-term production testing on Block 27 in the Llanos basin of Central Colombia and a foreign currency translation loss of \$1,190,821.

### Going concern uncertainty:

The Company has incurred a loss in the three months ended September 30, 2013 of \$517,924 (three months ended September 30, 2012 - \$1,095,691) and has an accumulated deficit of \$94,500,442 (June 30, 2013 - \$93,982,518). The Company is in the early exploration and development stage and is subject to risks and challenges similar to other companies in a comparable stage of exploration. These risks include, but are not limited to, dependence on key individuals, successful exploration and the ability to secure adequate financing to meet the minimum capital required to successfully complete the projects, political risk relating to maintaining property licenses in good standing and continuing as a going concern. Management estimates that the funds available as at September 30, 2013 will not be sufficient to meet the Company's potential capital expenditures through September 30, 2014. The Company will have to raise additional funds to continue operations. Although the Company has been successful in raising funds to date, there can be no assurance that adequate funding will be available in the future, or available on terms acceptable to the Company. Failure to meet its funding commitments with its partners may result in the loss of the Company's exploration and evaluation interests.

The challenges of securing requisite funding beyond September 30, 2013 and the continued estimated operating losses cast significant doubt on the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts or classification of liabilities that might be necessary should the Company not be able to continue as a going concern.

### Exploration and evaluation assets:

All of the Company's oil and gas activities are conducted jointly with others. The Company enters into exploration agreements with other parties, pursuant to which Brownstone may earn interests in the underlying exploration and evaluation assets by issuing common shares and/or making cash payments and/or incurring expenditures in varying amounts by varying dates. Failure by the Company to issue such shares, make such cash payments or incur such expenditures can result in a reduction or loss of the Company's interests.

The Company's accounts reflect only its proportionate interests in its oil and gas activities. The following is a summary of the Company's exploration and evaluation assets:

|   | Colombia (a)   | Israel (b)       | USA (c)          | Canada (d)       | Argentina (e)  | Total             |
|---|----------------|------------------|------------------|------------------|----------------|-------------------|
|   | \$             | \$               | \$               | \$               | \$             | \$                |
| <b>Balance at July 1, 2012</b>                  | 34,745,055     | 4,614,117        | 3,646,119        | 1,116,757        | 1,019,100      | 45,141,148        |
| Net additions                                   | 6,255,290      | 6,067,145        | 1,148,394        | 13,711           | 111,334        | 13,595,874        |
| Disposals                                       | (6,140,400)    | -                | -                | -                | -              | (6,140,400)       |
| Impairment of exploration and evaluation assets | (34,313,636)   | (1,380,604)      | (588,818)        | -                | (111,334)      | (36,394,392)      |
| Foreign currency translation                    | 504,891        | 364,260          | 171,002          | -                | 32,100         | 1,072,253         |
| <b>Balance at June 30, 2013</b>                 | 1,051,200      | 9,664,918        | 4,376,697        | 1,130,468        | 1,051,200      | 17,274,483        |
| Net additions                                   | (174,767)      | -                | (29,519)         | 12,689           | (112,956)      | (304,553)         |
| Impairment of exploration and evaluation assets | -              | -                | -                | -                | (87,056)       | (87,056)          |
| Foreign currency translation                    | (21,099)       | (208,708)        | (94,180)         | -                | (22,700)       | (346,687)         |
| <b>Balance at September 30, 2013</b>            | <b>855,334</b> | <b>9,456,210</b> | <b>4,252,998</b> | <b>1,143,157</b> | <b>828,488</b> | <b>16,536,187</b> |

(a) Colombia:

For the three months ended September 30, 2013, included in net additions was \$831,014 (three months ended September 30, 2012 - \$1,701,390) of revenue from sales of oil generated from long-term production testing on Block 27 in the Llanos Basin of Central Colombia. During the year ended June 30, 2013, the Company spent \$6,255,290 on exploration and evaluation of the blocks in Colombia, net of \$7,917,608 oil sales revenue generated from long-term production testing (Block 27(i) and Canaguaro Block). The Canaguaro Block was sold in June 2013 for total gross proceeds of US\$6,000,000. Included in the statement of cash flows is the cash spent on expenditures and evaluation, net of oil sales from long-term production testing.

A summary of the Company's private participating interests in the Colombian blocks as at September 30, 2013 and June 30, 2013 is as follows:

|                                  | <b>Block 27<br/>(i)</b> | <b>Block 36<br/>(ii)</b> |
|----------------------------------|-------------------------|--------------------------|
| Private participation interest   | 34.25%                  | 14%                      |
| Increased costs assumed          | 50%                     | 20%                      |
| Increased participation interest | 45.275%                 | 18.2%                    |

- (i) Block 27: The Company has a 34.25% private participating interest on the block and is required to pay 50% of the capital cost of the work program incurred during the exploration and production phases of the block, and will be entitled to receive 45.275% of all net production revenue, until all aggregate costs have been recouped, following which the Company will be obligated to fund 34.25% of any ongoing costs in order to be entitled to receive 34.25% of any further net production revenue.

The Company and its partners have successfully met the Phase 1 work commitments to process and interpret 474 km of 2D seismic and drill one exploration well for Block 27 and the operator has submitted to the Agencia Nacional de Hidrocarburos ("ANH"), a Colombian government oil and gas agency an Extension Application for the Flami-1 Evaluation Program. In September 2013, the US\$50,000 letter of guarantee lodged by the Company's bank in support of Brownstone's share of the remaining Phase I work commitments expired and the collateral relating to the letter of guarantee was released. The Company has a US\$1,850,000 letter of guarantee issued by the Company's bank to the ANH which expires in March 2014 and is guaranteed by a performance security guarantee ("PSG") issued by Export Development Canada ("EDC"), a Canadian federal government agency, for the Phase 2 work commitments.

- (ii) Block 36: The Company has a 14% private participating interest on the block and is required to pay 20% of the capital cost of the work program incurred during the exploration and production phases of the block, and will be entitled to receive 18.2% of all net production revenue, until all aggregate costs have been recouped, following which the Company will be obligated to fund 14% of any ongoing costs in order to be entitled to receive 14% of any further net production revenue.

Subsequent to September 30, 2013, the Company relinquished its private participating interest in Block 36 located in the Llanos Basin of Central Colombia. The Company has no further obligations or liabilities in respect of the Block subject to the release of the letters of credit provided to the ANH. The operator of the block has submitted to the ANH a letter of guarantee to replace the US\$1,100,000 letter of guarantee provided by the Company's bank

on its behalf of which US\$554,000 is secured by the Company and held in restricted cash and US\$546,000 is guaranteed by a PSG issued by EDC for which the Company has indemnified EDC. Management believes that the letter of guarantee will be released with-in the next 12 months.

- (iii) Block 21: Under an amending agreement dated February 28, 2012 to the original participation agreement in respect to the Block LLA 21, the Company had paid US\$3,875,000 towards the drilling of two wells in fiscal 2013. Following the completion and testing of the wells, which were subsequently abandoned, Brownstone waived its rights to an income production participation going forward and thus, has no further financial obligations.

Subsequent to September 30, 2013, the ANH called and Brownstone paid US\$567,027 of the US\$2,700,000 letter of guarantee on Block 21 provided by the Company's bank in support of its share of the operator's obligations on the Block. The ANH informed the Company that the operator of the block breached its commitment to the ANH by not delivering certain information when required, a breach which the operator has denied. On November 1, 2013, the remaining balance of the \$2,700,000 letter of guarantee on Block 21 expired. Brownstone is currently negotiating with the operator to compensate the Company for the amount that was paid to the ANH.

- (b) Israel:

As at September 30, 2013 and June 30, 2013, the Company has the following participating interests in Israel and is required to fund its share of participating interest:

|                        | <b>Gabriella Block (i)</b> | <b>Yitzhak Block (i)</b> | <b>Samuel Block (iii)</b> |
|------------------------|----------------------------|--------------------------|---------------------------|
| Participating Interest | 15%                        | 15%                      | 6.75%                     |

- (i) Gabriella Block: On February 11, 2013, the Company was informed by Adira Energy Israel Ltd., the operator of the Israeli Blocks (the "Operator") that it had suspended all operations with regard to drilling the Gabriella well until further notice. The failure of the 70% party, Modi'in Energy LP, to finance its obligations under the joint operating agreement was given as the reason for the suspension. Brownstone has met its share of the financing obligations under the joint operating agreement.

On June 30, 2013, the Company and its license partners entered into a settlement and release agreement. Pursuant to the agreement, Brownstone's net share of the costs total US\$3,504,579, which has been recorded in exploration and evaluation assets on the consolidated statements of financial position as at June 30, 2013. The costs are Brownstone's proportionate share of all costs associated with the Gabriella Block that have been incurred in connection with the drilling of the first well.

During the year ended June 30, 2013, the milestone dates for certain work to be performed in order to maintain the license for the property were not met. Following application by the Operator of the Block, the Ministry of Energy and Water of the State of Israel (the "Ministry") approved the extension of the license expiry date to September 1, 2014 and of the applicable milestone dates.

The following table sets out the work program that must be completed in order to maintain the Gabriella Block:

| <b>Gabriella Work Program</b>  | <b>Milestone Dates</b> |
|--|------------------------|
| Submitting a request for approving an operator                               | February 28, 2014      |
| Signing a rig contract   | April 30, 2014         |
| Submitting the results of an Anisotropic PSDM and coherent sub surface model | July 31, 2014          |
| Spud the first well  | August 31, 2014        |

- (ii) Yitzhak Block: On June 30, 2013, the Operator had applied to the Ministry for an extension of the milestone dates and approval was received in October 2013 with a new expiry date of the license of October 15, 2014.

The following table sets out the current work program that must be completed in order to maintain the Yitzhak Block:

| <b>Yitzhak Work Program</b>   | <b>Milestone Dates</b> |
|---|------------------------|
| Submitting the Environmental Impact Assessment to the Central District Planning Committee | January 1, 2014        |
| Execute a contract with a drilling contractor   | September 30, 2014     |
| Spud the first well   | September 30, 2014     |

- (iii) Samuel Block: During the year ended June 30, 2013, the milestone dates for certain work on the property were not met. The Samuel license expired on July 31, 2013 and subsequent to September 30, 2013, Brownstone and the other license holders of the Samuel Block have relinquished their interests back to the State of Israel.

(c) USA:

The Company has participating interests of between 7.5% to 28.57% in various acreages in the Piceance/Uinta basin in the USA and is required to fund its share of the participating interests.

During the three months ended September 30, 2013, the Company sold some of its USA interests for total proceeds of \$19,391 (US\$18,629) and received \$10,128 (US\$9,749) in net oil sales revenue from long-term production testing.

(d) Canada:

The Company has a 50% interest in the exploration licenses of the Rimouski, Rimouski North, Trois-Pistoles and Shawinigan properties in the St. Laurent Lowlands, Quebec. The Company is required to fund its share of the costs incurred on the properties. The properties are in an area where there is a moratorium on drilling pending the results of the Quebec Government's review of fracking.

During three months ended September 30, 2013, the Company spent \$12,689 (year ended June 30, 2012 - \$13,711) to maintain the properties in good standing.

(e) Argentina:

The Company has a 25% interest in the Vaca Mahuida Block in the Province of Rio Negro, Argentina. Under the terms of the participation agreement governing Brownstone's interest, the Company is required to fund 50% of the costs to be incurred in the conduct of the work program on the property.

During the three months ended September 30, 2013, the Company reverse accruals of \$112,956 that was recorded as at June 30, 2013 and the Company recorded an impairment charge of \$87,056. The impairment was recognized upon a review of the Company's interest in the Block and its estimated recoverable amount of US\$805,530. The recoverable amount was determined based on the amount for which the Company has agreed to relinquish its 25% working interest to Petrolifera Petroleum (Americas) Limited Sucursal Argentina ("PPAL"), the operator of the Block, subsequent to September 30, 2013. The relinquishment is subject to certain conditions including the approval by the Province of Rio Negro of the Exploitation Concession on the Area (the Vaca Mahuida Block). There is no certainty that the Exploitation Concession for the Block will be approved by the Province of Rio Negro.

## Investments:

The fair value and cost of investments are as follows:

|                           | Fair Value          | Cost                 |
|---------------------------|---------------------|----------------------|
| <b>September 30, 2013</b> | <b>\$ 2,096,394</b> | <b>\$ 13,750,659</b> |
| June 30, 2013             | 1,667,208           | 13,750,659           |

As at September 30, 2013, the original cost of investments exceeded fair value by \$11,654,265 as compared to \$12,083,451 as at June 30, 2013. The decrease for the three months ended September 30, 2013 was due to the net change in unrealized gains on investments of \$429,186.

The fair value of the Company's investments as reflected in its consolidated financial statements and calculated in accordance with IFRS and its accounting policies may differ from the actual proceeds of disposition that would be realized by the Company. For example, the amounts at which the Company's publicly-traded investments could be disposed of currently may differ from fair values based on market quotes, as the value at which significant ownership positions are sold is often different than the quoted market price due to a variety of factors such as premiums paid for large blocks or discounts due to illiquidity.

## Results of Operations

The Company's selected quarterly results for the eight most recently completed interim financial periods are as follows:

|   | Quarter ended      |               |                |                   |
|---|--------------------|---------------|----------------|-------------------|
|   | September 30, 2013 | June 30, 2013 | March 31, 2013 | December 31, 2012 |
| Net investment gains (losses)                                   | \$ 429,186         | \$ (231,949)  | \$ (410,312)   | \$ (674,534)      |
| Net loss for the period   | (517,924)          | (32,396,668)  | (1,327,113)    | (6,040,709)       |
| Total comprehensive loss for the period                         | (843,909)          | (31,404,339)  | (380,017)      | (5,488,984)       |
| Loss per share based on loss for the period – basic and diluted | (0.00)             | (0.25)        | (0.01)         | (0.05)            |

|   | September 30, 2012 | June 30, 2012  | March 31, 2012 | December 31, 2011 |
|---|--------------------|----------------|----------------|-------------------|
| Net investment gains (losses)             | \$ (287,466)       | \$ (1,361,788) | \$ (3,848,424) | \$ 2,154,987      |
| Net profit (loss) for the period          | (1,095,691)        | (2,688,493)    | (21,915,937)   | 893,858           |
| Total comprehensive loss for the period   | (2,737,183)        | (1,901,522)    | (22,730,621)   | (53,707)          |
| Earnings (loss) per share based on profit |                    |                |                |                   |
| (loss) for the period – basic and diluted | (0.01)             | (0.02)         | (0.17)         | 0.01              |

No dividends were declared by the Company during any of the periods indicated.

### Three months ended September 30, 2013 and 2012:

For the three months ended September 30, 2013, the Company recorded a net change in unrealized gains on investments of \$429,186 as compared to a net change in unrealized losses on investments of \$287,466 for the three months ended September 30, 2012. The net change in unrealized gains (losses) on investments in both periods related to the net write-up (write-down) to market on the company's investments.

For the three months ended September 30, 2013, the Company recorded interest and other income of \$4,006 as compared to \$48,458 for the three months ended September 30, 2012. Interest income is primarily composed of interest income earned on investments in bankers' acceptances and cash deposits. In the current period, the cash deposits were much lower which decreases the interest earned.

For the three months ended September 30, 2013, operating, general and administrative expenses increased by \$119,487 to \$840,246 from \$720,759 for the three months ended September 30, 2012. The increase was primarily due to an increase in foreign exchange loss and salaries/consulting fees offset by a decrease in stock-based compensation expense and other office and general expenses as discussed below.

The following is the breakdown of the Company's operating, general and administrative expenses for the indicated three month periods ended September 30. Details of the changes follow the table:

|   | 2013              | 2012              |
|---|-------------------|-------------------|
| Salaries and consulting fees (a)                      | \$ 432,955        | \$ 360,575        |
| Foreign exchange loss (gain) (b)                      | 209,804           | (51,544)          |
| Other office and general (c)                          | 66,390            | 198,552           |
| Professional fees                                     | 54,596            | 51,710            |
| Stock-based compensation expense (d)                  | 49,275            | 127,972           |
| Travel and promotion                                  | 16,074            | 15,316            |
| Other employment benefits                             | 6,536             | 6,745             |
| Shareholder relations, transfer agent and filing fees | 4,616             | 11,433            |
|   | <b>\$ 840,246</b> | <b>\$ 720,759</b> |

- (a) Salaries and consulting fees increased by \$72,380 for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012, due to an increase in consulting fees for the current period.



- (b) During the three months ended September 30, 2013, the Company had a foreign exchange loss of \$209,804 as compared to a foreign exchange gain of \$51,544 for the three months ended September 30, 2012, a decrease of \$261,348. The Company experienced a foreign exchange loss due to the increase in the value of the Canadian dollar versus the U.S. dollar during the quarter, which decreased the Canadian dollar value of the Company's U.S. dollar denominated monetary assets as compared to the three months ended September 30, 2012.
- (c) Other office and general decreased by \$132,162 for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012. The decrease was primarily due to a decrease in bank service charges and fees relating to the Company's outstanding letters of guarantees to the ANH and PSGs from the EDC, to \$20,593 from \$131,913 for the three months ended September 30, 2012.
- (d) Stock-based compensation expense decreased by \$78,697 for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012. The decrease was due to a decrease in the number of stock options which vested during the current period as compared to the prior year period and a decrease in the fair value of options granted during the current period. Stock options granted vest at three-month intervals over 18 months and are accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value of these options is estimated at the date of grant using the Black-Scholes option pricing model, and expensed over the vesting periods based on the graded method. Unvested forfeited stock options are not expensed during the period.

For the three months ended September 30, 2013, the Company recorded an impairment on exploration and evaluation assets totalling \$87,056 (three months ended September 30, 2012 – nil) on its Argentinean exploration and evaluation asset. See "Exploration and evaluation assets" section.

For the three months ended September 30, 2013, the Company recorded an income tax expense of \$23,814 as compared to \$135,924 for the three months ended September 30, 2012. The income tax expense is due to the recording of an accrual of minimum income tax payable due in Colombia.

Loss for the three months ended September 30, 2013 was \$517,924 (\$0.00 per share) as compared to \$1,095,691 (\$0.01 per share) for the three months ended September 30, 2012.

For the three months ended September 30, 2013, the Company recorded a loss from the exchange differences on translation of foreign operations of \$325,985 resulting in total comprehensive loss for the period of \$843,909. The loss from the exchange differences on translation of foreign operations was primarily due to the increase in the value of the Canadian dollar versus the U.S. dollar during the quarter, which decreased the Canadian dollar value of the Company's U.S. dollar denominated exploration and evaluation assets held by foreign subsidiaries. For the three months ended September 30, 2012, the Company recorded a loss from the exchange differences on translation of foreign operations of \$1,641,492 resulting in total comprehensive loss for the period of \$2,737,183.

## **Cash Flows**

### **Three months ended September 30, 2013 and 2012:**

During the three months ended September 30, 2013, the Company used cash of \$890,226 in operating activities as compared to \$1,286,099 during the three months ended September 30, 2012.

During the three months ended September 30, 2013, net cash used in investing activities was \$1,033,051 as compared to \$6,139,557 during the three months ended September 30, 2012. During the three months ended September 30, 2013, the Company spent cash on expenditures on exploration and evaluation assets of \$1,117,578 as compared to cash expenditures of \$5,609,983 during the three months ended September 30, 2012, a decrease that continues to reflect the Company's decreased oil and gas activities, including as a result of dispositions. During the three months ended September 30, 2012, the Company purchased \$500,000 of investments.

For the three months ended September 30, 2013, the Company had a net decrease in cash and cash equivalents of \$1,923,227 as compared to \$7,425,656 for the three months ended September 30, 2012, primarily from a decrease in cash spent on exploration and evaluation assets. For the three months ended September 30, 2013, the Company also had a gain from the exchange rate changes on its foreign operations' cash balances of \$20,702, leaving a cash and cash equivalents balance of \$7,692,489 as at September 30, 2013 as compared to an exchange loss of \$70,402, leaving a cash and cash equivalents balance of \$10,700,948 as at September 30, 2012.

### Segmented information:

Reporting segments are defined as components of an enterprise about which separate financial information is available, that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. All of the Company's operations relate to direct and indirect investments in the oil and gas sector. The Company's significant segments include six distinct geographic areas: Colombia, Israel, Canada, United States, Argentina and Brazil. There were no changes in the reportable segments since June 30, 2013.

The accounting policies applied to Brownstone's operating segments are the same as those described in the summary of significant accounting policies except that certain expenses and other items are not allocated to the individual operating segments when determining income or loss, but are attributed to the Canadian operations where the corporate head office is located.

The following is segmented information as at and for the three months ended September 30, 2013:

|                  | Three months ended<br>September 30, 2013 |                        | As at September 30, 2013             |               |               |
|------------------|--|------------------------|--------------------------------------|---------------|---------------|
|                  | Interest and<br>other income             | Loss for the<br>period | Exploration and<br>evaluation assets | Other assets  | Total assets  |
| Canada and other | \$ 1,644                                 | \$ 287,621             | \$ 1,143,157                         | \$ 10,193,786 | \$ 11,336,943 |
| Israel           | 1,478                                    | 14,961                 | 9,456,210                            | 37,674        | 9,493,884     |
| United States    | -  | -                      | 4,252,998                            | 17,660        | 4,270,658     |
| Colombia         | 884                                      | 102,591                | 855,334                              | 1,097,525     | 1,952,859     |
| Argentina        | -  | 112,751                | 828,488                              | 20,256        | 848,744       |
| Brazil           | -  | -                      | -                                    | 130,314       | 130,314       |
|                  | \$ 4,006                                 | \$ 517,924             | \$ 16,536,187                        | \$ 11,497,215 | \$ 28,033,402 |

The following is segmented information for the three months ended September 30, 2012 and as at June 30, 2013:

|                  | Three months ended<br>September 30, 2012 |                   | As at June 30, 2013                  |               |               |
|------------------|--|-------------------|--------------------------------------|---------------|---------------|
|                  | Interest and<br>other income             | Loss for the year | Exploration and<br>evaluation assets | Other assets  | Total assets  |
| Canada and other | \$ 35,166                                | \$ 979,255        | \$ 1,130,468                         | \$ 11,443,473 | \$ 12,573,941 |
| Israel           | -  | 11,416            | 9,664,918                            | 78,918        | 9,743,836     |
| United States    | -  | -                 | 4,376,697                            | 18,814        | 4,395,511     |
| Colombia         | 13,292                                   | 105,020           | 1,051,200                            | 1,488,705     | 2,539,905     |
| Argentina        | -  | -                 | 1,051,200                            | 14,622        | 1,065,822     |
| Brazil           | -  | -                 | -                                    | 133,943       | 133,943       |
|                  | \$ 48,458                                | \$ 1,095,691      | \$ 17,274,483                        | \$ 13,178,475 | \$ 30,452,958 |

### Liquidity and capital resources:

| <b>Consolidated statements of financial position highlights</b>  |                           |                      |
|--|---------------------------|----------------------|
|  | <b>September 30, 2013</b> | <b>June 30, 2013</b> |
| Cash and cash equivalents  | \$ 7,692,489              | \$ 9,595,064         |
| Investments, at fair value                                       | 2,096,394                 | 1,667,208            |
| Exploration and evaluation assets                                | 16,536,187                | 17,274,483           |
| Total assets   | 28,033,402                | 30,452,958           |
| Total liabilities  | 1,926,198                 | 3,551,120            |
| Share capital, warrants and broker warrants, contributed surplus | 121,012,712               | 120,963,437          |
| Foreign currency translation reserve                             | (405,066)                 | (79,081)             |
| Deficit  | (94,500,442)              | (93,982,518)         |
| Working Capital  | 9,571,017                 | 8,992,430            |

Accounts payable and accrued liabilities decreased by \$1,552,280 to \$1,926,198 as at September 30, 2013 as compared to \$3,478,478 as at June 30, 2013. As at September 30, 2013, the accounts payable and accrued liabilities included \$1,653,817 for exploration and evaluation cash calls as compared to \$3,056,557. As at September 30, 2013, included in accounts payable and accrued liabilities is \$158,383 for a Colombian equity tax as compared to \$240,501 as at June 30, 2013. The Colombian government implemented a new equity tax in December 2010, which Brownstone is required to pay based on the net equity of its Colombian branch office, subject to certain adjustments.

The Company has committed and is required to meet all of its drilling and related expenditures as they become due to maintain the Company's interests in its oil and gas properties (see "Exploration and evaluation assets" section). These exploration and evaluation assets' obligations are not fixed and cannot be pre-determined with certainty. Failure to meet the obligations may result in the dilution or loss of the Company's interests.

The Company's cash and cash equivalents and investments as at September 30, 2013 would be sufficient to meet the Company's current liabilities.

As at September 30, 2013, the Company had working capital of \$9,571,017 as compared to working capital of \$8,992,430 as at June 30, 2013. The increase in working capital since June 30, 2013 was primarily due to the increase in the fair value of the Company's investment portfolio and the reclassification of restricted cash to current during the three months ended September 30, 2013.

As at September 30, 2013, the Company had restricted cash totaling \$569,789 (US\$554,000) (June 30, 2013 - \$634,925 (US\$604,000)), all of which was current, as collateral to the Royal Bank of Canada ("RBC") for a letter of guarantee issued by RBC for Block 36 in Colombia. The restricted cash is held in Guaranteed Investment Certificates ("GICs"), which are renewed on a monthly basis at the prevailing interest rate (0.02% per annum as at September 30, 2013 and June 30, 2013). The Company has applied to the ANH to release the letter of guarantee since the work commitment on Block 36 has been met.

As at September 30, 2013 and June 30, 2013, the Company also has US\$5,096,000 PSG from EDC as collateral for letters of guarantee issued by RBC. The letters of guarantee are provided to ANH to secure Brownstone's private participating interests and exploration in Colombia Llanos exploration Blocks 21, 27, and 36 and to ensure that the Company fulfill its commitments under the blocks. Of the US\$5,096,000, US\$2,700,000 are in respect of the work commitment for Block 21 that was completed by the drilling of two exploration wells in the third quarter of 2013 and that letter of guarantee has expired on November 1, 2013. As noted in the exploration and evaluation assets section, subsequent to September 30, 2013, the ANH called US\$567,027 of the US\$2,700,000 letter of guarantee on Block 21. Brownstone has paid the cash payment to the ANH and is currently negotiating with the operator to compensate the Company for the amount that was paid.

The Company continues to have no long-term debt. The Company is currently generating cash from the sale of crude oil produced from Block 27 in Colombia, however, its existing cash reserves and anticipated ongoing cash flow from Colombia's long-term production testing (based on current production levels and crude oil prices, both of which may decline) will not be sufficient to fund potential capital expenditures in Colombia and Israel through to September 30, 2014. In order to meet its operating and capital expenditure obligations as they become due, and until such time, if any, that the Company generates sufficient cash from the sale of crude oil to do so, Brownstone will have to rely on external sources of capital. The Company expects to have to raise additional funds through debt and/or equity financings to meet its obligations and will consider, where warranted, strategic dispositions of certain of its interests in order to raise funds and/or reduce its capital expenditure requirements. The Company's ability to access the debt and equity markets and sell property interests when required will depend upon factors beyond its control, such as economic and political conditions that may affect the capital markets generally and the oil and gas industry specifically, including conditions pertaining to the countries in which it operates. The Company's inability to raise sufficient capital to fund its operations and growth may result in the loss of some or all of the Company's interests and, accordingly, could have a material adverse effect on the Company's business, financial condition, and results of operations, and its ability to continue as a going concern.

### **Investor relations:**

During the three months ended September 30, 2013, Brownstone's management handled the Company's investor relations activities.

**Related party transactions:**

- (a) Compensation to key management personnel and directors during the three months ended September 30 were as follows:

| Type of expense                  | 2013              | 2012              |
|----------------------------------|-------------------|-------------------|
| Salaries and consulting fees     | \$ 269,187        | \$ 199,986        |
| Other short-term benefits        | 5,499             | 5,798             |
| Stock-based compensation expense | 40,836            | 88,301            |
|                                  | <b>\$ 315,522</b> | <b>\$ 294,085</b> |

Key management personnel are the Chairman and Chief Executive Officer, President and Chief Operating Officer, Chief Financial Officer and Vice President, Corporate & Legal Affairs.

- (b) During the three months ended September 30, 2013, the Company granted 2,550,000 options to directors and officers of the Company, with an exercise price of \$0.10 per share and expiring on September 9, 2018.

During the year ended June 30, 2013, the Company granted 1,950,000 options to directors and officers of the Company, with an exercise price of \$0.17 per share and expiring on November 28, 2017.

**Off-Balance sheet arrangements:**

As at September 30, 2013, the Company has indemnified EDC for the full amount of the US\$5,096,000 (June 30, 2013 – US\$5,096,000) PSGs provided by the EDC. See "Liquidity and capital resources" for additional information regarding this contingent liability.

**Management of capital:**

There were no changes in the Company's approach to capital management during the three months ended September 30, 2013. The Company's capital includes equity comprised of share capital, warrants and broker warrants, contributed surplus, foreign currency translation reserve, and deficit. To date, the Company has not declared any cash dividends to its shareholders as part of its capital management program. The Company's current capital resources are sufficient to discharge its liabilities as at September 30, 2013.

**Risk management:**

- (a) Market risk:

There were no changes in the way the Company manages market risk during the three months ended September 30, 2013. The Company manages market risk by having a portfolio which is not singularly exposed to any one issuer; however, its investment activities are currently concentrated primarily in the oil and gas resource industry.

The following table shows the estimated sensitivity of the Company's after-tax net loss for the three months ended September 30, 2013 from a change in the closing bid price of the Company's investments with all other variables held constant as at September 30, 2013:

| Percentage of change in closing bid price | Decrease in net after-tax loss from % increase in closing bid price | Increase in net after-tax loss from % decrease in closing bid price |
|---|---|---|
| 2%  | \$ 36,372   | \$ (36,372)   |
| 4%  | 72,745  | (72,745)  |
| 6%  | 109,117   | (109,117)   |
| 8%  | 145,490   | (145,490)   |
| 10%                                       | 181,862   | (181,862)   |

The following table shows the estimated sensitivity of the Company's after-tax net loss for the three months ended September 30, 2012 from a change in the closing bid price of the Company's investments with all other variables held constant as at September 30, 2012:

| Percentage of change in closing bid price | Decrease in net after-tax loss from % increase in closing bid price | Increase in net after-tax loss from % decrease in closing bid price |
|---|---|---|
| 2%  | \$ 51,772   | \$ (51,772)   |
| 4%  | 103,545   | (103,545)   |
| 6%  | 155,317   | (155,317)   |
| 8%  | 207,090   | (207,090)   |
| 10%                                       | 258,862   | (258,862)   |

(b) Currency risk:

The Company presently holds funds in Canadian dollars but a significant amount of its costs are denominated in U.S. dollars, Colombian pesos, and Argentinean pesos. The Company does not engage in any hedging activities to mitigate its foreign exchange risk. A change in the foreign exchange rate of the Canadian dollar versus another currency may increase or decrease the value of the Company's financial instruments. The Company does not hedge its foreign currency exposure.

The following assets and liabilities were denominated in foreign currencies:

|   | September 30, 2013 | June 30, 2013 |
|---|--------------------|---------------|
| Denominated in U.S. dollars:              |                    |               |
| Cash and cash equivalents                 | \$ 7,239,512       | \$ 8,014,927  |
| Restricted cash                           | 569,789            | 634,925       |
| Prepays and receivables                   | 999,735            | 1,089,282     |
| Income tax receivable                     | 84,632             | 144,471       |
| Exploration and evaluation assets         | 15,393,030         | 16,144,015    |
| Accounts payable and accrued liabilities  | (1,849,939)        | (3,338,441)   |
| Net assets denominated in U.S. dollars    | 22,436,759         | 22,689,179    |
| Denominated in Brazilian reals:           |                    |               |
| Cash and cash equivalents                 | 130,314            | 133,943       |
| Net assets denominated in Brazilian reals | 130,314            | 133,943       |

|   | September 30, 2013 | June 30, 2013    |
|---|--------------------|------------------|
| Denominated in Argentinean pesos:           |                    |                  |
| Cash and cash equivalents                   | 20,256             | 14,622           |
| Accounts payable and accrued liabilities    | (18,004)           | (53,469)         |
| Income taxes payable                        | -                  | (72,642)         |
| Net assets denominated in Argentinean pesos | <u>2,252</u>       | <u>(111,489)</u> |
| Denominated in Colombian pesos:             |                    |                  |
| Cash and cash equivalents                   | 30,743             | 282,773          |
| Net assets denominated in Colombian pesos   | <u>30,743</u>      | <u>282,773</u>   |

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the three months ended September 30, 2013 from a change in the U.S. dollar exchange rate in which the Company has significant exposure with all other variables held constant as at September 30, 2013:

| Percentage change in U.S. dollar exchange rate | Decrease in total comprehensive loss from an increase in % in the U.S. dollar exchange rate | Increase in total comprehensive loss from a decrease in % in the U.S. dollar exchange rate |
|--|---|--|
| 2%   | \$ 329,820  | \$ (329,820)   |
| 4%   | 659,641   | (659,641)  |
| 6%   | 989,461   | (989,461)  |
| 8%   | 1,319,281   | (1,319,281)  |
| 10%  | 1,649,102   | (1,649,102)  |

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the year ended June 30, 2013 from a change in the U.S. dollar exchange rate in which the Company has significant exposure with all other variables held constant as at June 30, 2013:

| Percentage change in U.S. dollar exchange rate | Decrease in total comprehensive loss from an increase in % in the U.S. dollar exchange rate | Increase in total comprehensive loss from a decrease in % in the U.S. dollar exchange rate |
|--|---|--|
| 2%   | \$ 333,531  | \$ (333,531)   |
| 4%   | 667,062   | (667,062)  |
| 6%   | 1,000,593   | (1,000,593)  |
| 8%   | 1,334,124   | (1,334,124)  |
| 10%  | 1,667,655   | (1,667,655)  |

## Risks:

Brownstone's financial condition, results of operation and business are subject to certain risks, which may negatively affect them. Certain of these risks are described below in addition to elsewhere in this MD&A.

### (a) Exploration and Development

The business of exploring for, developing and producing oil and gas involves a high degree of risk. Oil and gas reserves may never be found or, if discovered, may not be result in production at reasonable costs or profitability. The business of exploring, developing and producing is also

capital intensive and, to the extent that cash flows from operating activities and external sources become limited or unavailable, the ability of Brownstone and of its operating partners to meet their respective financial obligations which are necessary to maintain their interests in the underlying properties could be impaired, resulting in those of the interests.

(b) Investment Risks:

The Company acquires securities of public and private companies from time to time, which are primarily junior or small-cap resource companies. The market values of these securities can experience significant fluctuations in the short and long term due to factors beyond the Company's control. Market value can be reflective of the actual or anticipated operating results of the companies and/or the general market conditions that affect the oil & gas sector as a whole, such as fluctuations in commodity prices and global political and economical conditions. The Company's investments are carried at fair value, and unrealized gains/losses on the securities and realized losses on the securities sold could have a material adverse impact on the Company's operating results. The recent decline in stock prices of the types of companies in which the Company invests have been very significant and such prices might take an extended time, to recover if they do at all.

(c) Dependence Upon Operating Partners:

Brownstone's oil and gas activities are conducted through partners in respect of which the Company is not the operator. Brownstone is dependent upon its operating partners for the financial and technical support, which they contribute to the Company's oil and gas properties. If Brownstone's operating partners are unable to fulfill their own contractual obligations, the Company's interests could be jeopardized, resulting in project delays, additional costs and loss of the interests.

(d) Environmental:

The Company's oil and gas operations are subject to environmental regulations in the jurisdictions in which it operates. Environmental legislation is evolving in a manner which will likely require stricter standards and enforcement, increased costs, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. Environmental hazards may exist on the properties in which the Company holds interests which are presently unknown to the Company and which have been caused by previous or existing owners or operators of the properties or by illegal mining activities.

(e) Governmental:

Government approvals and permits are often generally required in connection with the Company's operations. To the extent such approvals are required and not obtained, the Company may be delayed or prohibited from proceeding with planned exploration or development of properties. Amendments to current laws, regulations and permits governing operations and activities of oil and gas companies, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in capital expenditures or require abandonment or delays in development of new properties. Although the governments of the various countries in which Brownstone operates have been stable recently, there is no assurance that political and



economic conditions will remain stable. Political and economic instability may impede the Company's ability to continue its exploration activities in the manner currently contemplated.

(f) Foreign Operations:

The Company is exposed to risks of political instability and changes in government policies, laws and regulations in every country in which the Company has oil & gas interests. The Company holds interests in Argentina, Colombia, Israel and in other jurisdictions that may be affected in varying degrees by political stability, government regulations relating to the oil & gas industry and foreign investment therein. Any changes in regulations or shifts in political conditions are beyond the Company's control and may adversely affect the Company's business. The Company's operations may be affected in varying degrees by government regulations, including those with respect to restrictions on production, price controls, export controls, income taxes, expropriation of property, employment, land use, water use, environmental legislation and mine safety. There is no assurance that permits can be obtained, or that delays will not occur in obtaining all necessary permits or renewals of such permits for existing properties or additional permits required in connection with future exploration and development programs. In the event of a dispute arising at the Company's foreign operations, the Company may be subject to the exclusive jurisdiction of foreign courts or may not be successful in subjecting foreign persons to the jurisdiction of courts in Canada. The Company may also be hindered or prevented from enforcing its rights with respect to a government entity or instrumentality because of the doctrine of sovereign immunity.

(g) Fluctuations in Crude Oil Prices:

The price of the Company's common shares, and consolidated financial results and exploration, development and other oil and gas activities may in the future be significantly and adversely affected by declines in the price of crude oil. The price of oil fluctuates widely and is affected by numerous factors beyond the Company's control, such as interest rates, exchange rates, inflation or deflation, fluctuation in the value of the US dollar and foreign currencies, global and regional supply and demand, the political and economic conditions and production costs of major oil-producing countries throughout the world, and the cost of substitutes, inventory levels and carrying charges. Future material price declines could cause continued development of and commercial production from the properties in which the Company holds an interest to be impracticable. Depending on the price of oil, cash flow from the Company's operations may not be sufficient and the Company could be forced to discontinue production and may lose the Company's interest in, or may be forced to sell, some of the Company's properties. Future production from the Company's properties is dependent upon the price of oil being adequate to make these properties economic.

**Changes in Accounting Policies:**

Except as described below, the same accounting policies and methods of computation were followed in the preparation of the interim consolidated statements as were followed in the preparation and described in note 3 of the annual consolidated financial statements as at and for the year ended June 30, 2013.

Effective July 1, 2013, the Company has adopted the following new and revised standards, along with any consequential amendments. These changes were made in accordance with the applicable transitional provisions.

- (a) IFRS 7, *Financial Instruments, Disclosures*, amended to provide more extensive quantitative disclosures for financial instruments that are offset in the consolidated statement of financial position or that are subject to enforceable master netting similar arrangements. The Company has assessed and determined that the amendments to IFRS 7 did not result in any change in its disclosures for financial instruments.
- (b) IFRS 10, *Consolidated Financial Statements*, requires consolidation of an investee only if the investor possesses power over the investee, has exposure to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect its returns. Detailed guidance is provided on applying the definition of control. The Company has assessed its consolidation conclusions on July 1, 2013 and determined that the adoption of IFRS 10 did not result in any change in the consolidation status of any of its subsidiaries and investees.
- (c) IFRS 11, *Joint Arrangements*, supersedes IAS 31, *Interests in Joint Ventures*, and requires joint arrangements to be classified either as joint operations or joint ventures depending on the contractual rights and obligations of each investor that jointly controls the arrangement. For joint operations, a company recognizes its share of assets, liabilities, revenues and expenses of the joint operation. An investment in a joint venture is accounted for using the equity method as set out in IAS 28, *Investments in Associates and Joint Ventures* (amended in 2011). The other amendments to IAS 28 did not affect the Company. The Company has concluded that the adoption of IFRS 11 did not result in any changes in the accounting.
- (d) IFRS 12, *Disclosure of Interests in Other Entities*, requires the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with an entity's interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. The Company has assessed and determined that the adoption of IFRS 12 did not result in any change in its disclosures of interests in other entities.
- (e) IFRS 13, *Fair Value Measurement*, provides the guidance on the measurement of fair value and related disclosures through a fair value hierarchy. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk.

The Company has fair valued its investments in publicly-traded investments (securities of issuers that are public companies) based on the closing trade price at the consolidated statement of financial position date or the closing trade price on the last day the security traded if there were no trades at the consolidated statement financial position date. Management views that this policy provides a more indicative fair value price to sell its publicly-traded investments in an orderly transaction in the principal market at the consolidated statement of financial position date. In prior periods, publicly-traded investments were fair valued based on quoted closing bid prices at the consolidated statement of financial position date or the closing bid price on the last day the security traded if there were no trades at the consolidated statement of financial position date.

As permitted under the transitional provision, IFRS 13 was applied on a prospective basis and, accordingly, the adoption of the new policy had no effect on prior years. The effect on the current period is to increase investments as at July 1, 2013 by \$48,504.

- (f) IAS 19R, *Employee Benefits*, includes a number of amendments to the accounting for defined benefit plans, including actuarial gains and losses that are now recognised in other comprehensive income and permanently excluded from profit and loss; expected returns on plan assets that are

no longer recognised in profit or loss, instead, there is a requirement to recognise interest on the net defined benefit liability (asset) in profit or loss, calculated using the discount rate used to measure the defined benefit obligation; and unvested past service costs are now recognised in profit or loss at the earlier of when the amendment occurs or when the rated restructuring or termination costs are recognised. Other amendments include new disclosures, such as, quantitative sensitivity disclosures. The Company has assessed its employee benefits, including unused vacation accrual, and determined that the amendments to IAS 19R did not have any significant impact on the consolidated financial statements.

- (g) IAS 27, *Separate Financial Statements*, as a result of the issue of the new consolidation suite of standards, IAS 27 has been reissued, as the consolidation guidance will now be included in IFRS 10. IAS 27 will now only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The Company does not prepare separate financial statements, therefore, IAS 27 does not impact the Company.
- (h) IAS 28, *Investments in Associates and Joint Ventures*, as a consequence of the issue of IFRS 10, IFRS 11 and IFRS 12, IAS 28 has been amended and will provide the accounting guidance for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. The amended IAS 28 will be applied by all entities that are investors with joint control of, or significant influence over, an investee. None of these disclosures requirements are applicable for interim condensed consolidated financial statements, unless significant events and transactions in the interim period require that they be provided. Accordingly, the Company has not made such disclosures.
- (i) IAS 32, *Financial Instruments, Presentation* was amended to clarify the requirements for offsetting financial assets and liabilities. The amendments clarify that the right of offset must be available on the current date and cannot be contingent on a future date. The Company has early adopted IAS 32 effective on July 1, 2013 and determined that there was no significant impact on the consolidated financial statements.

### **Critical accounting estimates:**

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Critical accounting estimates used in the preparation of the Company's interim financial statements include the Company's valuation of its privately-held investments, estimate of recoverable fair value on exploration assets, the valuation related to the Company's deferred tax assets ("DTA") and deferred tax liabilities ("DTL"), and the Company's estimate of inputs for the calculation of the fair value of stock-based compensation expense, the Company's own warrants and broker warrants, and unlisted warrants of public companies held by Brownstone.

### Valuation of privately-held investments:

The valuation of these investments ("private investments") requires management to assess the current financial status and prospects of private investments based upon potentially incomplete or unaudited

financial information provided by the investee company, on management's general knowledge of the private investment's activities, and on any political or economic events that may impact upon the private investment specifically, and to attempt to quantify the impact of such events on the fair value of the investment. In addition to any events or circumstances that may affect the fair value of a particular private investment, management can consider general market conditions that may affect the fair value of either a particular private investment or of a group, segment or complete portfolio of private investments.

Changes in the fair value of our private investments for company-specific reasons have tended to be infrequent. Changes as a result of general market conditions may be more frequent from period to period during times of significant volatility, however, given the relatively small size of our private investment portfolio, such changes are not expected to have a material impact on our financial condition or operating results. For the three months ended September 30, 2013 and 2012, the Company had no change in unrealized gains or losses on investments relating to its private company investments.

Estimate of recoverable fair value on exploration and evaluation assets:

The costs of acquiring interests in exploration and evaluation assets are carried at cost until they are brought into production, at which time they are depleted on a unit-of-production method based on estimated recoverable proven oil and gas reserves. The Company's recorded value of exploration assets is based on historical costs that it expects to be recoverable in the future. The Company operates in an industry that is exposed to a number of risks and uncertainties, including exploration risk, development risk, commodity price risk, operating risk, political, ownership, funding, and currency risks, as well as environmental risk and overall economic conditions. All of these factors are potentially subject to significant change, out of the Company's control, and such changes are not determinable. Additionally, failure to conduct additional work on the Company's exploration properties may result in their loss. Accordingly, there is always the potential for a material adjustment to the value assigned to exploration assets.

At each reporting period, the Company's management reviews the status of all of its exploration properties, taking into account all of the factors noted above, in order to make an estimate of the recoverable value of each property. When management believes that the value of a property has been impaired, the Company will write down the value of the property to management's estimate of its recoverable value. As well, if the Company determines that an exploration project is not viable due to the risks described above or to unsatisfactory drill results, the Company will write-off the carrying value of the property. During the three months ended September 30, 2013, the Company recorded an impairment of \$87,056 (three months ended September 30, 2012 – nil) on its on its exploration and evaluation assets.

Deferred tax assets:

Deferred tax is provided using the statement of financial position method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

DTL are recognized for all taxable temporary differences and DTA are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses. The Company does not record DTA to the extent that it considers it is not more likely than not that deductible temporary differences, the carry forward of unused tax credits and unused tax losses can be utilized.

Management determined, based upon expectations for future taxable income, that it believes that it is not more likely than not it will realize the tax benefits of the DTA during the next several years.

Stock-based Compensation Expense/Warrants and Broker Warrants:

The Company uses the Black-Scholes option pricing model to calculate stock-based compensation expense and the fair value of the warrants and broker warrants issued under the Company's private placements. The model requires six key inputs: exercise price, market price at date of issue, risk free interest rate, expected dividend yield, expected life and expected volatility. The first two inputs are facts rather than estimates, while the risk free interest rate, expected life, expected volatility and expected dividend yield (estimated at 0% based on the Company's history of not paying any dividends) are based on the Company's estimates. A shorter expected life of the option, lower volatility number or higher dividend yield used would result in a decrease in stock-based compensation expense. A longer expected life of the option or a higher volatility number used would result in an increase in stock-based compensation expense. The Company is also required to estimate the future forfeiture rate of options based on historical information in its calculation of stock-based compensation expense. These estimates involve considerable judgment and are, or could be, affected by significant factors that are out of the Company's control.

During the three months ended September 30, 2013, the Company granted 2,980,000 stock options exercisable at \$0.10 per share expiring on September 9, 2018.

During the year ended June 30, 2013, the Company granted 2,390,000 options exercisable at \$0.17 per share expiring on November 28, 2017.

The fair value of the options granted during the three months ended September 30, 2013 was estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

|  |           |
|--|-----------|
| Black-Scholes option valuation model assumptions used (weighted average) |           |
| Expected volatility  | 111.4%    |
| Expected dividend yield  | 0%        |
| Risk-free interest rate  | 1.8%      |
| Expected option life in years  | 3.8 years |
| Expected forfeiture rate   | 4.9%      |
| Fair value per stock option granted on September 10, 2013                | \$ 0.04   |

The fair value of the options granted during the year ended June 30, 2013 was estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

|  |           |
|--|-----------|
| Black-Scholes option valuation model assumptions used (weighted average) |           |
| Expected volatility  | 104.7%    |
| Expected dividend yield  | 0%        |
| Risk-free interest rate  | 1.2%      |
| Expected option life in years  | 3.7 years |
| Expected forfeiture rate   | 5.5%      |
| Fair value per stock option granted on November 29, 2012                 | \$ 0.12   |

The expected volatility is based on the historical volatility over the life of the option at Brownstone's share price. The Company has not paid any cash dividends historically and has no plans to pay cash dividends in the foreseeable future. The risk-free interest rate is based on the yield of Canadian

Benchmark Bonds with equivalent terms. The expected option life in years represents the period of time that options granted are expected to be outstanding based on historical options granted.

Valuation of Unlisted Warrants of Public Companies:

The Company uses the Black-Scholes option pricing model to calculate the fair value of unlisted warrants of public companies if there are sufficient and reliable observable market inputs; if no such market inputs are available, the warrants are valued at intrinsic value. The model requires six key inputs: risk free interest rate, exercise price, market price at date of issue, expected dividend yield, expected life and expected volatility. The first four inputs are facts rather than estimates, while the expected life, expected volatility and expected dividend yield (estimated at 0% based on the Company's history of not paying any dividends) are based on the Company's estimates. A shorter expected life of the warrant, lower volatility number or higher dividend yield used would result in a decrease in the fair value of the warrant. A longer expected life of the warrant or a higher volatility number used would result in an increase in the fair value of the warrant. These estimates involve considerable judgment and are, or could be, affected by significant factors that are out of the Company's control. As at September 30, 2013 and June 30, 2013, there were not sufficient reliable observable market inputs and thus, the Company valued the warrants in its portfolio using their intrinsic value.

**Outstanding Share Data:**

As at November 28, 2013, the number of common shares of the Company outstanding and the number of common shares issuable pursuant to other outstanding securities of Brownstone are as follows:

| <b>Common shares</b>               | <b>Number</b>      |
|------------------------------------|--------------------|
| Outstanding                        | <b>129,794,289</b> |
| Issuable under options             | <b>12,760,080</b>  |
| Issuable under warrants            | <b>7,951,454</b>   |
| <b>Total diluted common shares</b> | <b>150,505,823</b> |

Refer to note 6 of the notes to the consolidated financial statements as at and for the three months ended September 30, 2013 for details of the Company's share capital as at September 30, 2013.

**Additional Information:**

Additional information relating to Brownstone may be found on the Company's website at [www.brownstoneenergy.com](http://www.brownstoneenergy.com) or under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com).