BROWNSTONE
-ENERGY INC-

Brownstone Energy Inc.

Management's Discussion and Analysis

For the quarter ended: **September 30, 2011**

Date of report: **November 29, 2011**

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 financial statements") and notes thereto as at and for the three months ended September 30, 2011. See "Significant Accounting Policies" elsewhere in this MD&A.

On July 1, 2011, the Company transitioned from financial reporting under Canadian Generally Accepted Accounting Principles ("CGAAP") to the International Financial Reporting Standards ("IFRS"), for periods commencing on and after that date. Prior to the transition, the Company prepared its interim and annual consolidated financial statements in accordance with CGAAP. The interim financial statements as at and for the three months ended September 30, 2011, which are discussed in this MD&A, have been prepared in accordance with the IFRS accounting policies which the Company expects to adopt in its annual consolidated financial statements as at and for the year ended June 30, 2012. All comparative financial information contained in the interim financial statements has been restated from CGAAP.

Unless indicated otherwise, all financial data in this MD&A has been prepared in accordance with 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 future working capital requirements, including its ability to satisfy such requirements, increases in future production volume on its Colombian property, 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, 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: 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, risks relating to oil and gas exploration activities generally, including the uncertainties inherent in estimating production volumes, strength of the Canadian, U.S. and global economies, foreign exchange fluctuations, political and economic conditions in the countries in which the Company's property interests are located 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.

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") was incorporated in 1987 under the laws of the Province of British Columbia and its common shares are publicly traded on the TSX Venture Exchange ("TSXV") under the symbol "BWN" and on the OTCQX under the symbol "BWSOF". The Company changed its name from Brownstone Ventures Inc. to Brownstone Energy Inc. effective January 18, 2011. Brownstone is a Canadian-based, energy focused company with direct interests in oil and gas exploration projects, including varying interests in three off-shore Israel concessions and four blocks in the Llanos Basin of Colombia.

Highlights:

- As at September 30, 2011, the Company has working capital of $40,238,808 as compared to working capital of $46,507,056 as at June 30, 2011, a decrease of 13.5%, primarily due to the expenditures on exploration and evaluation assets and the decrease in the value of investments during the current quarter.

- As at September 30, 2011, exploration and evaluation assets increased by 15.4% to $48,536,008 as compared to $42,053,011 as at June 30, 2011, primarily from exploration of the Company's properties in Colombia.

- Subsequent to September 30, 2011, the Canaguay-1 well in Colombia was shut in for service. Commencing on October 30, 2011 the well began producing oil again and the well has performed: Average Oil Production: 1,052 BOPD; Average Water Production: 490 BWPD; Average Fluid Production: 1,542 BFPD; Average Watercut: 32%.

- Subsequent to September 30, 2011, the operator of Block 27 has advised that the new deviated wellbore has progressed to approximately 9,000 feet of depth. The well is being drilled to a total depth of 10,850 feet.

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

	July 1, 2010	Year ended June 30, 2011		**Three months ended September 30, 2011**	
	Net Book Value	Net Expenditures (proceeds)	Net Book Value	**Net Expenditures**	**Net Book Value**
Joint ventures in Colombia properties (a)					
Acquisition	$ 2,850,040	$ -	$ 2,850,040	**$ -**	**$ 2,850,040**
Exploration	7,997,964	10,225,359	18,223,323	**2,972,870**	**21,196,193**
Foreign currency translation	253,774	(1,317,457)	(1,063,683)	**1,704,159**	**640,476**
	11,101,778	8,907,902	20,009,680	**4,677,029**	**24,686,709**
Joint ventures in USA properties					
Acquisition	14,271,014	(263,328)	14,007,686	**-**	**14,007,686**
Exploration	2,342,454	863,748	3,206,202	**259,967**	**3,466,169**
Foreign currency translation	(675,641)	(1,357,785)	(2,033,426)	**1,098,227**	**(935,199)**
	15,937,827	(757,365)	15,180,462	**1,358,194**	**16,538,656**
Joint ventures in Argentina properties					
Acquisition	4,128,331	-	4,128,331	**-**	**4,128,331**
Foreign currency translation	114,070	(385,201)	(271,131)	**298,400**	**27,269**
	4,242,401	(385,201)	3,857,200	**298,400**	**4,155,600**
Joint ventures in Canadian properties					
Acquisition	797,353	-	797,353	**-**	**797,353**
Exploration	205,929	71,540	277,469	**-**	**277,469**
	1,003,282	71,540	1,074,822	**-**	**1,074,822**
Joint ventures in Israel					
Exploration	$ -	$ 2,011,871	$ 2,011,871	**$ -**	**$ 2,011,871**
Foreign currency translation	-	(81,024)	(81,024)	**149,374**	**68,350**
	-	1,930,847	1,930,847	**149,374**	**2,080,221**
Total oil & gas properties	$ 32,285,288	$ 9,767,723	$ 42,053,011	**$ 6,482,997**	**$ 48,536,008**

(a) During the three months ended September 30, 2011, the Company spent $2,972,870 on exploration and evaluation of the blocks in Colombia, net of oil sales revenue. The Company has private participating interests in four blocks located in the Llanos Basin of Central Colombia. A summary of the Company's interests in the blocks as follows:

	Canaguaro Block (i)	Block 21	Block 27(ii)	Block 36
Participation interest	25%	35%	34.25%	14%
Increased costs assumed	31.25%	50%	50%	20%
Increased participation interest	25%	45.5%	45.275%	18.2%

(i) The Company is required to pay US$1,250,000 in sunk costs of which US$375,000 was paid upon execution of the definitive agreement in 2010 and US$875,000 is to be paid from the Company's share of production (of which US$829,601 has been accrued as at September 30, 2011). If commercial production occurs on the block, the Company will be required to pay a 6% overriding royalty to Concorcio Canaguaro on its share of production (in addition to royalties payable to the ANH), and a one-time success fee to Concorcio Canaguaro of up to US$1 million, payable following the completion of the first 12 months of commercial production from the Canaguay-1 well and determined based upon the average daily production of the well during that first year in excess of 351 barrels of oil per day. For the three months ended September 30, 2011, the Company reduced its exploration and evaluation assets by capitalizing crude oil sales revenue of $553,045 (US$564,217) (year ended June 30, 2011 – $259,228 (US$265,385)), which was generated from the long-term production testing of the Canaguaro well currently underway.

Subsequent to September 30, 2011, the Canaguay-1 well was shut in for service, which included a cleanout of the well, replacing the electrical submersible pump (ESP), and placing the new ESP at a deeper depth in the well closer to the producing zone. Commencing on October 30, 2011 the well began producing oil again. On November 15, 2011, the well was shut in for two days to complete a repair on the pump. Excluding those two days, the well has performed from October 30, 2011 to November 29, 2011: Average Oil Production: 1,052 BOPD; Average Water Production: 490 BWPD; Average Fluid Production: 1,542 BFPD; Average Watercut: 32%.

(ii) Mani-1 Well: Block 27

On August 10, 2011, the operator of the block received its blanket environmental permit paving the way to proceed with the drilling of its first well on Block 27. Construction of the location began on August 29, 2011.

Subsequent to September 30, 2011, the operator spudded the first well with a rig contracted from Saxon Energy Services on October 21, 2011. The operator has advised that while drilling the 12-1/4" intermediate section at 4,470 feet, a number of mechanical issues were experienced and the operator abandoned the lower portion of the well from 4470 feet to 2100 feet, and re-commenced drilling operations immediately below surface casing. As of November 29, 2011, the new deviated wellbore has progressed to approximately 9,000 feet of depth and experienced no further issues. The well is being drilled to a total depth of

approximately 10,850 feet. Prospective targets include the oil bearing intervals in the Mirador and Une Formations, with the Carbonera formation representing a secondary target.

A summary of all other properties is in the Company's MD&A for the year ended June 30, 2011 which was filed on September 28, 2011 which may be found under the Company's profile on SEDAR at www.sedar.com.

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For the remainder of fiscal 2012, a total discretionary budget of approximately $15,000,000 has been primarily allocated to the Company's most advanced projects and head office costs. Management may increase or decrease the budget depending on exploration results and in response to ongoing volatility in the capital markets. The Company believes its focused exploration strategy will make efficient use of cash while maintaining momentum on key projects. Brownstone is adequately financed to fund its existing priority projects for fiscal 2012.

Investments:

The fair value and cost of investments are as follows:

	Fair Value	Cost
September 30, 2011	**$ 9,748,982**	**$ 21,990,342**
June 30, 2011	12,350,483	22,219,575
July 1, 2010	17,174,119	32,093,349

As at September 30, 2011, the cost of investments exceeded fair value by $12,241,360 as compared to $9,869,092 as at June 30, 2010 and $14,919,230 as at July 1, 2010. The decrease for the three months ended September 30, 2011 was primarily due to the net change in unrealized losses on investments.

For details of the Company's accounting policies for investments, see (a) under "Significant Accounting Policies" elsewhere in this MD&A. The fair value of the Company's investments as reflected in its interim 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. The financial results for periods ending on or before June 30, 2010 were prepared in accordance with CGAAP. The financial results for the periods ending on September 30, 2010 to June 30, 2011 have been restated to IFRS.

	Quarter ended			
	September 30, 2011	June 30, 2011	March 31, 2011	December 31, 2010
Net investment gains (losses)	**(2,372,268)**	(706,975)	(145,552)	4,458,314
Profit (loss) for the period	**(3,343,326)**	(2,765,008)	(1,268,671)	3,046,580
Total comprehensive income (loss) for the period	**(131,773)**	(3,042,664)	(2,155,777)	1,902,039
Earnings (loss) per share based on profit (loss) for the period – basic	**(0.03)**	(0.02)	(0.01)	0.03
Earnings (loss) per share based on profit (loss) for the period – diluted	**(0.03)**	(0.02)	(0.01)	0.03
	September 30, 2010	June 30, 2010 (CGAAP)	March 31, 2010 (CGAAP)	December 31, 2009 (CGAAP)
Net investment gains (losses)	59,318	(3,865,090)	4,964,781	(268,671)
Profit (loss) for the period	(594,198)	(24,171,292)	3,512,888	(762,474)
Total comprehensive income (loss) for the period	(1,449,909)	(24,171,292)	3,512,888	(762,474)
Earnings (loss) per share based on profit (loss) for the period – basic	(0.01)	(0.28)	0.05	(0.01)
Earnings (loss) per share based on profit (loss) for the period – diluted	(0.01)	(0.28)	0.05	(0.01)

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

Three months ended September 30, 2011 and 2010:

The effect on the Company's results of operations from the changeover to IFRS from CGAAP was significant, primarily due to the accounting treatment of the functional currency (the effects of foreign exchange rates) and treatment of stock options under IFRS as compared to CGAAP (see the "Transition to IFRS" section). However, there was no material change to earnings (loss) per share from the changeover as previously reported. The results for the three months ended September 30, 2010 have been restated to reflect the adoption of IFRS. A reconciliation of the restated amounts can be found in Note 17 of the notes to the interim financial statements as at and for the three months ended September 30, 2011.

For the three months ended September30, 2011, the Company generated net realized losses on disposal of investments of $191,331 as compared to $1,003,846 for the three months ended September 30, 2010. For the three months ended September 30, 2011 and 2010, the Company realized net losses primarily from the disposition of a portion of its holdings in Dejour Energy Inc.

For the three months ended September 30, 2011, the Company recorded a net change in unrealized losses on investments of $2,372,268 as compared to a net change in unrealized gains on investments of $1,063,164 in the three months ended September30, 2010. Of the net change in unrealized losses

in the three months ended September30, 2011, $2,554,446 was due to the net write-down to market on the Company's investments offset by the reversal of net unrealized losses on the disposal of investments of $182,178. The net change in unrealized gains in the three months ended September 30, 2010, were due to the reversal of net unrealized losses on the disposal of investments of $1,406,219 offset by the net write-down to market on the Company's investments of $343,055.

For the three months ended September 30, 2011, the Company recorded interest and other income of $85,173 as compared to $76,847 for the three months ended September 30, 2010. Interest income is primarily composed of interest income earned on investments in banker's acceptances and cash deposits.

For the three months ended September30, 2011, operating, general and administrative expenses decreased by $163,774 to $836,438 from $1,000,212 for the three months ended September 30, 2010.

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

	2011	2010
Stock-based compensation expense (a)	**$ 387,851**	$ 291,907
Salaries, consulting and administrative fees (b)	**341,778**	252,447
Other office and general	**190,499**	151,624
Professional fees	**63,189**	58,399
Shareholder relations, transfer agent and filing fees	**28,198**	29,111
Other employment benefits	**14,114**	3,465
Travel and promotion (c)	**7,964**	30,523
Transaction costs (d)	**67**	24,051
Foreign exchange loss (gain) (e)	**(197,222)**	158,685
	$ 836,438	$ 1,000,212

(a) Stock-based compensation expense increased by $95,944 for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. The increase was due to an increase in stock options which were vested over the current period as compared to the prior year period. Stock options granted during the current and prior year 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 terminated stock options are not expensed during the period.

(b) Salaries, consulting and administrative fees increased by $89,331 for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. The increase was due a $50,000 bonus paid to an officer of the Company during the three months ended September 30, 2011, and a general increase in salaries and consultancy fees as compared to the prior year period.

(c) Travel and promotion decreased by $22,559 for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. The decrease was due to the timing in travelling related to the Company's oil and gas activities.

(d) Transactions costs decreased by $23,984 for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 due to a decrease in the volume of stock trading conducted by the Company. Transaction costs arise from purchases and dispositions of investments through brokers and are expense on settlement in accordance with the Company's accounting policy for investments.

(e) A foreign exchange gain of $355,907 for the three months ended September 30, 2011 reversed the losses recorded for the three months ended September 30, 2010 primarily due to the decrease in the value of the Canadian dollar versus the U.S. dollar during the quarter, which increased the Canadian dollar value of the Company's U.S. dollar denominated monetary assets. During the three months ended September 30, 2010, the Company experienced a foreign exchange loss 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 monetary assets.

For the three months ended September 30, 2011, the Company recorded an income tax expense of $28,462 as compared to an income tax benefit of $269,849 for the three months ended September 30, 2010. The income tax expense in the current period is due to the recording of a 3.5% withholding tax in Colombia from the sales of crude oil. The withholding tax can be used to offset any future tax payable but the Company does not foresee sufficient taxable profit in the near future. In the prior year period, the Company recorded an income tax benefit attributable to the expected income tax recoverable from taxable losses in that period, which would be carried back to prior years.

Loss for the three months ended September 30, 2011 was $3,343,326 ($0.03 per share) as compared to $594,198 ($0.01 per share) for the three months ended September 30, 2010. The net loss in the current period was primarily due to the accounting recognition of the decrease in the fair value of the Company's investments in accordance with the Company's accounting policies. The share prices of the Company's investments decreased during the current period while in the prior year period the net change in unrealized gains was primarily due to the reversal of net unrealized losses on the disposal of investments.

For the three months ended September 30, 2011, the Company recorded a gain from the exchange differences on translation of foreign operations of $3,211,553 resulting in total comprehensive loss for the period of $131,773. The gain from the exchange differences on translation of foreign operations was primarily due to the decrease in the value of the Canadian dollar versus the U.S. dollar during the quarter, which increased the Canadian dollar value of the Company's U.S. dollar denominated exploration and evaluation assets held by foreign subsidiaries. the For the three months ended September 30, 2010, the Company recorded a loss from the exchange differences on translation of foreign operations of $855,711 resulting in total comprehensive loss for the period of $1,449,909.

Cash Flows
Three months ended September 30, 2011 and 2010:

During the three months ended September 30, 2011, the Company used cash of $282,008 in operating activities as compared to $2,607,857 in the three months ended September 30, 2010. For the three months ended September 30, 2010, the Company had a net payment of $1,978,779 from accounts payable and accrued liabilities (of which $1,855,495 was accrued as at June 30, 2010 for seismic work on LLA-27 in Colombia).

During the three months ended September 30, 2011, the Company generated net cash in financing activities of $137,809 as compared to using cash of $191,685 during the three months ended September 30, 2010. During the three months ended September 30, 2011, the net cash generated in financing activities was primarily from a decrease of $137,809 in cash held at brokers as compared to an increase of $191,685 during the three months ended September 30, 2010.

During the three months ended September 30, 2011, net cash generated in investing activities was $1,201,083 as compared to $1,385,834 during the three months ended September 30, 2010. During the three months ended September 30, 2011, $4,124,447 of cash was released from restricted cash following the return by the Agencia Nacional de Hidrocarburos ("ANH"), a Colombian government agency, a letter of guarantee in the amount of US$1,620,000 provided by the Company and the extension of a US$2,700,000 Performance Security Guarantees ("PSG") by Export Development Canada ("EDC") to the Company's bank in support of other letters of guarantee given to ANH. The Company spent cash on expenditures on exploration and evaluation assets of $2,961,266 as compared to cash expenditures of $1,581,846 during the three months ended September 30, 2010. During the three months ended September 30, 2011, the Company had proceeds from dispositions of investments of $87,902 as compared to $4,932,791 during the three months ended September 30, 2010.

For the three months ended September 30, 2011, the Company had a net increase in cash and cash equivalents of $1,056,884 as compared to a net decrease in cash and cash equivalents of $1,413,708 for the three months ended September 30, 2010. For the three months ended September 30, 2011, the Company also had a loss from the exchange rate changes on its foreign operations' cash balances of $38,607, leaving a cash and cash equivalents balance of $30,852,083 as at September 30, 2011 as compared to an exchange gain of $39,757, leaving a cash and cash equivalents balance of $458,279 as at September 30, 2010.

Segmented information:

Operating segments are defined as components of an enterprise about which separate financial information is available, that is evaluated regularly by management 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 during the three months ended September 30, 2011.

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 profit or loss, but are attributed to the Canadian operations where the corporate head office is located. As at September 30, 2011, June 30, 2011, and July 1, 2010, no customer accounted for more than 10% of revenues.

The following is segmented information as at and for the three months ended September 30, 2011:

	Three months ended September 30, 2011		**As at September 30, 2011**		
	Interest and other income	**Loss for the period**	**Exploration and evaluation assets**	**Other assets**	**Total assets**
Canada and other	**$ 79,625**	**$ 3,264,190**	**$ 1,074,822**	**$ 41,497,720**	**$ 42,572,542**
Colombia	**5,548**	**66,104**	**24,686,709**	**874,616**	**25,561,325**
United States	**-**	**-**	**16,538,656**	**107,668**	**16,646,324**
Argentina	**-**	**-**	**4,155,600**	**22,610**	**4,178,210**
Israel	**-**	**13,032**	**2,080,221**	**5,881**	**2,086,102**
Brazil	**-**	**-**	**-**	**157,992**	**157,992**
	$ 85,173	**$ 3,343,326**	**$ 48,536,008**	**$ 42,666,487**	**$ 91,202,495**

The following is segmented information for the three months ended September 30, 2010 and as at June 30, 2011:

	Three months ended September 30, 2010		As at June 30, 2011		
	Interest and other income	Loss for the period	Exploration and evaluation assets	Other assets	Total assets
Canada and other	$ 63,567	$ 492,984	$ 1,074,822	$ 47,982,817	$ 49,057,639
Colombia	13,280	101,214	20,009,680	352,860	20,362,540
United States	-	-	15,180,462	6,227	15,186,689
Argentina	-	-	3,857,200	20,931	3,878,131
Israel	-	-	1,930,847	1,652	1,932,499
Brazil	-	-	-	173,855	173,855
	$ 76,847	$ 594,198	$ 42,053,011	$ 48,538,342	$ 90,591,353

The following is segmented information as at July 1, 2010:

	As at July 1, 2010		
	Exploration and evaluation assets	Other assets	Total assets
Canada and other	$ 1,003,282	$ 26,517,343	$ 27,520,625
United States	15,937,827	1,063,027	17,000,854
Colombia	11,101,778	18,108	11,119,886
Argentina	4,242,401	30,157	4,272,558
Brazil	-	165,990	165,990
	$ 32,285,288	$ 27,794,625	$ 60,079,913

Liquidity and capital resources:

Consolidated statements of financial position highlights	September 30, 2011	June 30, 2011	July 1, 2010
Cash and cash equivalents	**$ 30,852,083**	$ 29,833,806	$ 1,832,230
Investments, at fair value	**9,748,982**	12,350,483	17,174,119
Exploration and evaluation assets	**48,536,008**	42,053,011	32,285,288
Total assets	**91,202,495**	90,591,353	60,079,913
Total liabilities	**1,852,128**	1,497,064	2,113,363
Share capital, warrants and broker warrants, contributed surplus	**118,715,593**	118,327,742	82,453,692
Foreign currency translation reserve	**46,539**	(3,165,014)	-
Retained earnings (deficit)	**(29,411,765)**	(26,068,439)	(24,487,142)
Working Capital	**40,238,808**	46,507,05	20,394,295

Accounts payable and accrued liabilities increased by $355,064 to $1,852,128 as at September 30, 2011 as compared to $1,497,064 as at June 30, 2011 and decreased by $261,235 as compared to $2,113,363 as at July 1, 2010. As at September 30, 2011, the accounts payable and accrued liabilities included $281,404 for cash calls for exploration in Colombia, $861,872 in success fees due on the sale of petroleum (see "Exploration and evaluation assets" section) and $523,358 for a Colombian equity tax. The Colombian government implemented a new equity tax, whereby Brownstone is required to pay a tax based on the net equity of its Colombian branch office, subject to certain adjustments. As at June 30, 2011, the accounts payable and accrued liabilities included $255,911 in success fees due on the sale of petroleum, $400,415 for cash calls for the Canaguaro property and $566,779 for the Colombian equity tax. As at July 1, 2011, the accounts payable and accrued liabilities primarily included $1,855,495 of accrued liabilities for seismic work on Block 27 in Colombia.

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 loss of the Company's interests.

The Company's cash and cash equivalents, current restricted cash, investments, and due from brokers as at September 30, 2011 would be sufficient to meet the Company's current financial obligations as they become due.

As at September 30, 2011, the Company had working capital of $40,238,808 as compared to working capital of $46,507,056 as at June 30, 2011 and $20,394,295 as at July 1, 2011. The decrease in working capital since June 30, 2011 was primarily due to the expenditures on exploration and evaluation assets and the decrease in the value of investments during the current quarter.

The Company has no long-term debt.

As at September 30, 2011, the Company had restricted cash totaling $575,551 (US$554,000) as collateral to the Royal Bank of Canada ("RBC") for letters of guarantee issued by RBC. As at June 30, 2011, the Company had restricted cash totaling $4,699,998 (US$4,874,000) of which $4,165,776 (US$4,320,000) was current (July 1, 2010 - $5,286,967 (US$4,984,883)). The restricted cash is held

in GICs, which are renewed on a monthly basis at the prevailing interest rate (0.02% per annum as at September 30, 2011 (June 30, 2011 and July 1, 2010 – 0.03%)).

The GICs are held as collateral by RBC for letters of guarantee issued by RBC to ANH. The letters of guarantee are provided to ANH to secure Brownstone's interests and exploration in Colombia Llanos exploration Blocks 21, 27, and 36 and to ensure that the Company and its partners fulfill their commitments under the blocks.

In November 2010, EDC, a Canadian federal government agency, issued three PSGs totaling US$4,984,883 to RBC to secure certain of the letters of guarantee issued by RBC to ANH. As a result, the Company's restricted cash in the amount of the PSGs was released.

Investor relations:

During the three months ended September 30, 2011, Brownstone's management and Contact Financial Corp. ("Contact") handled the Company's investor relations activities. Contact is a strategic marketing and communications firm located in Vancouver, British Columbia. Contact provides advice to Brownstone with respect to corporate development, producing and distributing effective marketing communication tools, and increasing investor awareness.

Related party transactions:

All transactions with related parties have occurred in the normal course of operations and are recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

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

Type of expense	2011	2010
Salaries and consulting fees	**$ 234,188**	$ 187,937
Other short-term benefits	**12,137**	3,465
Stock-based compensation expense	**279,272**	215,936

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, 2011 the Company did not grant any options to directors and officers of the Company.

During the year ended June 30, 2011, the Company granted the following options to directors and officers of the Company:

Date Granted	Options Granted	Exercise Price	Expiry
September 21, 2010	1,000,000	$ 0.51	September 20, 2015
March 30, 2011	1,125,000	1.20	March 29, 2016
Total granted	2,125,000		

Off-Balance sheet arrangements:

As at September 30, 2011, the Company held restricted cash totaling $575,551 (US$554,000) (June 30, 2011 - $4,699,998 (US$4,874,000); July 1, 2010 - $5,286,967 (US$4,984,883)) which is used as collateral for oil and gas exploration associated with the Company's interests in Colombia. The Company has also indemnified EDC, US$4,984,833 for the full amount of the PSGs provided by the EDC. See "Liquidity and capital resources" for additional information regarding this contingent liability.

Management of capital:

The Company includes the following in its capital:

	September 30, 2011	June 30, 2011	July 1, 2010
Shareholders' equity comprised of			
Share capital	**$ 96,597,845**	$ 96,597,845	$ 65,017,344
Warrants and broker warrants	**6,873,384**	6,873,384	4,028,875
Contributed surplus	**15,244,364**	14,856,513	13,407,473
Foreign currency translation reserve	**46,539**	(3,165,014)	-
Deficit	**(29,411,765)**	(26,068,439)	(24,487,142)
	$ 89,350,367	$ 89,094,289	$ 57,966,550

The Company's objectives when managing capital are:

(a) to ensure that the Company maintains the level of capital necessary to meet the requirements of cash calls for the exploration of properties and from operators in joint venture properties;

(b) to ensure that the Company maintains the level of capital necessary to meet the requirements of its brokers;

(c) to allow the Company to respond to changes in economic and/or marketplace conditions by maintaining the Company's ability to purchase new investments and acquisitions of exploration properties;

(d) to give shareholders sustained growth in shareholder value by increasing shareholders' equity; and

(e) to maintain a flexible capital structure which optimizes the cost of capital at acceptable levels of risk.

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its underlying assets. The Company maintains or adjusts its capital level to enable it to meet its objectives by:

(a) realizing proceeds from the disposition of its investments; and

(b) raising capital through equity financings.

The Company is not subject to any capital requirements imposed by a regulator, except to the extent that it has pledged cash as collateral for certain letters of guarantee issued to ANH.

There were no changes in the Company's approach to capital management during the three months ended September 30, 2011. 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, 2011.

Financial instruments:

The investments operation of Brownstone's business involves the purchase and sale of securities and, accordingly, a significant portion of the Company's assets are currently comprised of financial instruments. The use of financial instruments can expose the Company to several risks, including market, credit, and liquidity risks. A discussion of the Company's use of financial instruments and their associated risks is provided below.

(a) Market risk:

Market risk is the risk that the fair value of, or future cash flows from, the Company's financial instruments will significantly fluctuate because of changes in market prices. The value of the financial instruments can be affected by changes in interest rates, foreign exchange rates, and equity and commodity prices. The Company is exposed to market risk in trading its investments, and unfavourable market conditions could result in dispositions of investments at less than favourable prices. Additionally, the Company adjusts its investments to fair value at the end of each reporting period. This process could result in significant write-downs of the Company's investments over one or more reporting periods, particularly during periods of overall market instability, which would have a significant unfavourable effect on Brownstone's financial position.

There were no changes to the way the Company manages market risk during the three months ended September 30, 2011. 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, 2011 from a change in the closing bid price of the Company's investments with all other variables held constant as at September 30, 2011:

Percentage of change in closing bid prices	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%	$ 170,120	$ (170,120)
4%	340,239	(340,239)
6%	510,359	(510,359)
8%	680,479	(680,479)
10%	850,599	(850,599)

The following table shows the estimated sensitivity of the Company's after-tax net loss for the year ended June 30, 2011 from a change in the closing bid price of the Company's investments with all other variables held constant as at June 30, 2011:

Percentage of change in closing bid prices	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%	$ 214,775	$ (214,775)
4%	429,550	(429,550)
6%	644,325	(644,325)
8%	859,100	(859,100)
10%	1,073,875	(1,073,875)

(b) Credit risk:

Credit risk is the risk of loss associated with the inability of a third party to fulfill its payment obligations. The Company is exposed to the risk that third parties that owe it money or securities (in connection with convertible or debt securities, for example) will not perform their underlying obligations and for funds held with banks for cash and cash equivalents. The Company may, from time to time, invest in debt obligations. As at September 30, 2011, June 30, 2011, and July 1, 2010, the Company did not hold any debt obligations. All funds in cash and cash equivalents are held in financial institutions that have a credit rating above AA and the Company believes it is not exposed to any significant loss.

There were no changes to the way the Company manages credit risk during the three months ended September 30, 2011. The Company is also exposed, in the normal course of business, to credit risk from the sale of its investments and advances to investee and joint venture companies.

The Company's maximum exposure to credit risk is:

	September 30, 2011	June 30, 2011	July 1, 2010
Cash and cash equivalents	**$ 30,852,083**	$ 29,833,806	$ 1,832,230
Restricted cash	**575,551**	4,699,998	5,286,967
Due from brokers	**91,059**	228,868	-
Promissory note receivable	**-**	-	2,070,140
Income taxes receivable	**1,053,614**	1,053,614	1,328,276
Other receivables	**345,198**	371,573	102,893
	$ 32,917,505	$ 36,187,859	$ 10,620,506

As at September 30, 2011, June 30, 2011 and July 1, 2010, the Company had the following significant receivables:

(i) As at September 30, 2011, the Company had accrued income taxes receivable of $1,053,614 (June 30, 2011 - $1,053,614; July 1, 2010 - $1,328,276) relating to refunds of taxes previously paid, from taxable losses carried back to prior years. The Company believes it is not exposed to credit risk since the amount is fully collectible from the Canadian government.

(ii) As at September 30, 2011, included in other receivables is $273,942 (June 30, 2011 - $255,911; July 1, 2010 - nil) relating from oil sales revenue. The Company is exposed to this credit risk since the amount is due from one counterparty.

(iii) As at July 1, 2010, the Company held a promissory note for $2,070,140 from Dejour, a company with a director who is also an officer of Brownstone. During the year ended June 30, 2011, the Company has received repayment of the promissory note in full from Dejour.

(c) Liquidity risk:

Liquidity risk is the risk that the Company will have sufficient cash resources to meet its financial obligations as they come due. The Company's liquidity and operating results may be adversely affected if the Company's access to the capital markets is hindered, whether as a result of a downturn in stock market conditions generally or related to matters specific to the Company, or if the value of the Company's investments declines, resulting in losses upon disposition. The Company generates cash flow primarily from its financing activities and proceeds from the disposition of its investments, in addition to interest earned on its investments. The Company has sufficient investments which primarily consist of freely tradable and relatively liquid equity securities to fund its obligations as they become due under normal operating conditions.

There were no changes to the way the Company manages liquidity risk during the three months ended September 30, 2011. The Company manages liquidity risk by reviewing the amount of margin available on a daily basis, and managing its cash flow. The Company holds investments which can be converted into cash when required. As at September 30, 2011, the Company was not using any margin but had $91,059 (June 30, 2011 - $228,868; July 1, 2010 - $0) due from its broker (cash held at a brokerage account).

The following table shows the Company's liabilities and potential due dates related to liquidity risk as at September 30, 2011:

	Payments due by period				
Liabilities and obligations	**Total**	**Less than 1 year**	**1 – 3 years**	**4 – 5 years**	**After 5 years**
Accounts payable and accrued liabilities	**$ 1,852,128**	**$ 1,852,128**	**$ -**	**$ -**	**$ -**
	$ 1,852,128	**$ 1,852,128**	**$ -**	**$ -**	**$ -**

The following table shows the Company's liabilities and potential due dates related to liquidity risk as at June 30, 2011:

	Payments due by period				
Liabilities and obligations	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Accounts payable and accrued liabilities	$ 1,497,064	$ 1,497,064	$ -	$ -	$ -
	$ 1,497,064	$ 1,497,064	$ -	$ -	$ -

The following table shows the Company's liabilities and potential due dates related to liquidity risk as at June 30, 2010:

	Payments due by period				
Liabilities and obligations	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Accounts payable and accrued liabilities	$ 2,113,363	$ 2,113,363	$ -	$ -	$ -
	$ 2,113,363	$ 2,113,363	$ -	$ -	$ -

The following table shows the Company's source of liquidity by assets as at September 30, 2011:

	Liquidity by period				
Assets	**Total**	**Less than 1 year**	**1 – 3 years**	**After 4 years**	**Non-liquid assets**
Cash and cash equivalents	**$ 30,852,083**	**$ 30,852,083**	**$ -**	**$ -**	**$ -**
Due from brokers	**91,059**	**91,059**	**-**	**-**	**-**
Prepaids and other receivables	**345,198**	**345,198**	**-**	**-**	**-**
Investments at fair value	**9,748,982**	**-**	**9,748,982**	**-**	**-**
Income taxes receivable	**1,053,614**	**1,053,614**	**-**	**-**	**-**
Restricted cash	**575,551**	**-**	**575,551**	**-**	**-**
Exploration and evaluation assets	**48,536,008**	**-**	**-**	**-**	**48,536,008**
	$ 91,202,495	**$ 32,341,954**	**$ 10,324,533**	**$ -**	**$ 48,536,008**

The following table shows the Company's source of liquidity by assets as at June 30, 2011:

	Liquidity by period				
Assets	Total	Less than 1 year	1 – 3 years	After 4 years	Non-liquid assets
Cash and cash equivalents	$ 29,833,806	$ 29,833,806	$ -	$ -	$ -
Due from brokers	228,868	228,868	-	-	-
Restricted cash – current	4,165,776	4,165,776			
Prepaids and other receivables	371,573	371,573	-	-	-
Investments at fair value	12,350,483	-	12,350,483	-	-
Income taxes receivable	1,053,614	1,053,614	-	-	-
Restricted cash	534,222	-	534,222	-	-
Exploration and evaluation assets	42,053,011	-	-	-	42,053,011
	$ 90,591,353	$ 35,653,637	$ 12,884,705	$ -	$ 42,053,011

The following table shows the Company's source of liquidity by assets as at July 1, 2010:

	Liquidity by period				
Assets	Total	Less than 1 year	1 – 3 years	After 4 years	Non-liquid assets
Cash and cash equivalents	$ 1,832,230	$ 1,832,230	$ -	$ -	$ -
Prepaids and other receivables	102,893	102,893	-	-	-
Promissory note receivable	2,070,140	2,070,140	-	-	-
Investments at fair value	17,174,119	-	17,174,119	-	-
Income taxes receivable	1,328,276	1,328,276	-	-	-
Restricted cash	5,286,967	-	5,286,967	-	-
Exploration and evaluation assets	32,285,288	-	-	-	32,285,288
	$ 60,079,913	$ 5,333,539	$ 22,461,086	$ -	$ 32,285,288

(d) Interest risk:

Interest risk is the impact that changes in interest rates could have on the Company's earnings and liabilities. As at September 30, 2011, June 30, 2011, and July 1, 2010, the Company did not have any interest rate risk liabilities. The Company holds a significant portion of cash equivalents in interest-bearing instruments and is exposed to the risk of changing interest rates.

The primary objective of the Company's investment activities is to preserve principal while at the same time maximizing the income it receives from its investments without significantly increasing risk. The Company places investments with high credit quality issuers. To minimize interest rate risk, the Company maintains its portfolio of cash equivalents in guaranteed investment certificates and bankers' acceptances with maturities of less than one year. The Company does not use any derivative instruments to reduce exposure to interest rate fluctuations.

(e) Currency risk:

Currency risk is the risk that the fair value of or future cash flows from the Company's financial instruments will fluctuate because of changes in foreign exchange rates. The Company's operations are exposed to foreign exchange fluctuations, which could have a significant adverse effect on its consolidated results of operations from time to time.

The Company presently holds funds in Canadian dollars but a significant amount of its costs are denominated in U.S. dollars, Argentinean pesos and Brazilian reals. 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, 2011	June 30, 2011	July 1, 2010
Denominated in U.S. dollars:			
Investments	**$ -**	$ -	$ 890,313
Cash and cash equivalents	**1,954,088**	69,779	1,063,028
Due from brokers	**91,015**	157,095	-
Restricted cash	**575,551**	4,699,998	5,286,967
Prepaids and other receivables	**276,525**	260,309	3,202
Exploration and evaluation assets	**47,461,186**	40,978,189	31,282,006
Accounts payable and accrued liabilities	**(1,780,376)**	(1,397,055)	(85,629)
Net assets denominated in U.S. dollars	**48,577,989**	44,768,315	38,439,887
Denominated in Brazilian reals:			
Cash and cash equivalents	**157,992**	173,855	165,990
Net assets denominated in Brazilian reals	**157,992**	173,855	165,990
Denominated in Argentinean pesos:			
Cash and cash equivalents	**1,217**	1,538	9,363
Prepaids and other receivables	**21,393**	19,393	20,794
Net assets denominated in Argentinean pesos	**22,610**	20,931	30,157
Denominated in Colombian pesos:			
Cash and cash equivalents	**600,945**	96,949	17,736
Prepaids and other receivables	**-**	-	372
Net assets denominated in Colombian pesos	**600,945**	96,949	18,108

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the three months ended September 30, 2011 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, 2011:

Percentage change in U.S. dollar	**Decrease in after-tax net loss from an increase in % in the U.S. dollar exchange rate**	**Increase in after-tax net loss from a decrease in % in the U.S. dollar exchange rate**
2%	**$ 723,812**	**$ (723,812)**
4%	**1,447,624**	**(1,447,624)**
6%	**2,171,436**	**(2,171,436)**
8%	**2,895,248**	**(2,895,248)**
10%	**3,619,060**	**(3,619,060)**

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the year ended June 30, 2011 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, 2011:

Percentage change in U.S. dollar exchange rate	Decrease in after-tax net loss from an increase in % in the U.S. dollar exchange rate	Increase in after-tax net loss from a decrease in % in the U.S. dollar exchange rate
2%	$ 665,675	$ (665,675)
4%	1,331,350	(1,331,350)
6%	1,997,025	(1,997,025)
8%	2,662,700	(2,662,700)
10%	3,328,376	(3,328,376)

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 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.

Transition to IFRS:

For all periods up to and including the year ended June 30, 2011, the Company prepared its interim financial statements in accordance with CGAAP. The interim financial statements as at and for the three months ended September 30, 2011 are the first the Company has prepared in accordance with IFRS. The interim financial statements are prepared in accordance with the accounting policies which the Company expects to adopt in its IFRS annual consolidated financial statements for the year ended June 30, 2012 and are based on IFRS as issued by the International Accounting Standards Board that the Company expects to be applicable at that time.

(a) Transition to IFRS Reconciliations:

The Company has disclosed the following CGAAP to IFRS reconciliations in note 17 of the Notes to the interim financial statements as at and for the three months ended September 30, 2011 (refer to that note for details):

(i) reconciliation of the consolidated statement of financial position and equity as at July 1, 2011;

(ii) reconciliation of the consolidated statement of financial position and equity as at September 30, 2010;

(iii) reconciliation of the consolidated statement of financial position and equity as at June 30, 2011;

(iv) reconciliation of the consolidated statement of total comprehensive loss for the three months ended September 30, 2010; and

(v) reconciliation of the consolidated statement of total comprehensive loss for the year ended June 30, 2011.

No reconciliation is required for the consolidated statement of cash flows as there are no significant differences.

(b) Significant Accounting Policy Changes and Exemptions Applied:

In preparing the interim financial statements, the opening consolidated statement of financial position was prepared as at July 1, 2010, the Company's Transition Date. The following explains the principal adjustments made in restating the previous CGAAP consolidated balance sheet as at July 1, 2010 and its previously published CGAAP consolidated financial statements for the three months ended September 30, 2010 and as at June 30, 2011. IFRS 1, *First-Time Adoption of International Financial Reporting Standards* allows first-time adopters certain exemptions from the retrospective application of IFRS.

The Company has elected to apply the following exemptions:

(i) IFRS 2 *Share-based Payment* ("IFRS 2") has not been applied to the options issued under the Company's stock option plan that vested prior to July 1, 2010.

(ii) The Company has elected to apply IFRS 3 prospectively to business combinations occurring after July 1, 2010. Business combinations occurring prior to the Transition Date have not been restated.

(iii) All exploration and evaluation assets are measured at the Transition Date at the amount determined under CGAAP. The Company has tested all exploration and evaluation assets included in accordance with IFRS 6 *Exploration for and Evaluation of Mineral Resources* and where necessary, reduced the carrying amount for any impairment.

(iv) The Company elected to adopt IFRS 9 from the Transition Date rather than January 1, 2015. All previously recognized financial assets and financial liabilities are designated as either amortized cost or at fair value through profit and loss based upon the facts and circumstances existing at the Transition Date.

(v) IFRS 1 offers the first-time adopter of IFRS the option to reset the foreign currency translation reserve that existed at the date of transition to IFRS to zero as an alternative to establishing a foreign currency translation reserve as if the accounting and translation principles in IAS 21 *The Effects of Changes in Foreign Exchange Rates* ("IAS 21") had always been used and the measurement of assets and liabilities had been as required by currently implemented IFRS. The Company has elected to utilize this option, and has reset the foreign currency translation reserve for all foreign operations to zero as of July 1, 2010. Future gains or losses on a subsequent disposal of any foreign operation will therefore exclude translation differences that arose before Transition Date.

The exceptions under IFRS 1 not to retrospectively apply IFRS at the Transition Date have all been applied.

Significant Accounting Policies:

Refer to note 2 of the Notes to the interim financial statements as at and for the three months ended September 30, 2011 for details of the Company's basis of preparation of the interim financial statements.

The significant accounting policies used in the presentation of the interim financial statements as at and for the three months ended September 30, 2011 are as follows:

(a) Oil and gas properties and exploration and evaluation assets:

(i) Exploration and evaluation assets:

Amounts included under exploration and evaluation assets relate to properties that are in preproduction and are undergoing exploration and evaluation.

All costs incurred in connection with the Company's oil and gas exploration and evaluation (acquisition, exploration for and development of oil and gas reserves) including certain overhead and dry-holes are capitalized less accumulated impairment losses. Such amounts include land acquisition costs, geological and geophysical expenditures, cost of drilling both productive and non-productive wells, gathering production facilities and equipment, and overhead expenses directly related to exploration and development activities. The Company capitalizes carrying costs directly attributable to its acquisition, exploration, and development activities, such as interest costs.
For preproduction cost centres, capitalized exploration and evaluation assets are assessed whether it is likely such net costs, in the aggregate, may be recovered in the future. Assets that are unlikely to be recovered are written down to their fair value. Impairment reviews take place where there is an indication of impairment or when a cost centre has been transferred into production cost centres. Impairment reviews are based on blocks which may contain more than one cash-generating unit.

(ii) Oil and gas properties:

Expenditures relating to producing properties will be included in oil and gas properties.

For production cost centres, capitalized oil and gas properties are depleted using the unit-of-production method based on net proved reserves for each cost centre. Costs subject to depletion include both the estimated costs required to develop proved undeveloped reserves and the associated addition to the asset retirement obligations. Costs of acquiring and evaluating significant unproved oil and gas properties are initially excluded from the depletion base.

When it is determined that proved oil and gas reserves are attributable to a property, or the property is considered to be impaired, the cost of the property and related expenditures or the impairment is added to the depletion base. The Company applies an impairment test to the net carrying value of oil and gas properties designed to ensure that such costs do not exceed the estimated amount ultimately recoverable. This amount is the aggregate of estimated undiscounted future net cash flows from production of proved reserves and the cost of unproved oil and gas properties less impairments.

Future cash flows are estimated using future prices and costs without discounting. Should the net carrying value of oil and gas properties exceed the amount ultimately recoverable, the amount of the impairment is determined by deducting the discounted estimated future cash flows from proved and probable reserves based on the future prices plus the cost of unproved properties, net of impairment allowances, from the carrying value of the related assets. Any reduction in the net carrying value, as a result of the impairment test, is included in depletion, depreciation and amortization expense.

(iii) Joint oil and gas activities:

All of the Company's oil and gas activities are conducted jointly with others. The Company's accounts reflect only the Company's proportionate interest in these activities.

For interests in jointly controlled assets and operations, the Company's share of the jointly controlled assets are classified according to the nature of the assets, the Company's share of any liabilities incurred jointly with the other parties, and the Company's share of any income and expenses incurred jointly with the partners are recognized in the consolidated financial statements.

Jointly controlled assets involve the joint control or joint ownership by partners of one or more assets dedicated to the purposes of the joint venture or partnership.

(b) Fair value of investments:

(i) Designation:

All investments are designated upon initial recognition at fair value through profit or loss, with changes in fair value reported in profit (loss).

(ii) Recognition, derecognition and measurement:

Regular purchases and sales of investments are recognized on the settlement date.

Investments at fair value through profit or loss are initially recognized at fair value. Transaction costs are expensed as incurred in the statement of comprehensive loss. Investments are derecognized when the rights to receive cash flows from the investments have expired or the Company has transferred substantially all risks and rewards of ownership.

Subsequent to initial recognition, all investments at fair value through profit or loss are measured at fair value. Gains and losses arising from changes in the fair value of the investments at fair value through profit or loss category are presented in the statement of comprehensive loss within unrealized gains or losses on investments in the period in which they arise.

(iii) Reclassification of investments:

The Company would only reclassify any financial assets when the Company changes its business model for managing the financial asset. Reclassifications are recorded at fair value at the date of reclassification, which becomes the new carrying value.

(iv) Determination of fair values:

The determination of fair value requires judgment and is based on market information where available and appropriate. At the end of each financial reporting period, the Company's management estimates the fair value of investments based on the criteria below and reflects such valuations in the consolidated financial statements.

The Company is also required to present its investments (and other financial assets and liabilities reported at fair value) into three hierarchy levels (Level 1, 2, or 3) based on the transparency of inputs used in measuring the fair value, and to provide additional disclosure in connection therewith.

1. Publicly-traded investments (i.e., securities of issuers that are public companies):

   a. Securities, including shares, options, and warrants which are traded on a recognized securities exchange and for which no sales restrictions apply are presented at fair value 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.

   b. Securities which are traded on a recognized securities exchange but which are escrowed or otherwise restricted as to sale or transfer are recorded at amounts discounted from market value to a maximum of 10%. In determining the discount for such investments, the Company considers the nature and length of the restriction.

   c. For options and warrants which are not traded on a recognized securities exchange, no market value is readily available. When there are sufficient and reliable observable market inputs, a valuation technique is used; if no such market inputs are available, the warrants and options are valued at intrinsic value, which is equal to the higher of the closing bid price at the consolidated statement of financial position date of the underlying security less the exercise price of the warrant or option, and zero.

2. Private company investments (securities of issuers that are not public companies):

   All privately-held investments (other than options and warrants) are initially recorded at the transaction price, being the fair value at the time of acquisition. Thereafter, at each reporting period, the fair value of an investment may, depending upon the circumstances, be adjusted using one or more of the valuation indicators described below. Options and warrants of private companies are carried at nil.

   The determinations of fair value of the Company's privately-held investments at other than initial cost are subject to certain limitations. Financial information for private companies in which the Company has investments may not be available and, even if available, that information may be limited and/or unreliable.

   Use of the valuation approach described below may involve uncertainties and determinations based on the Company's judgment and any value estimated from these techniques may not be realized or realizable.

   The following circumstances are used to determine if the fair value of a privately-held investment should be adjusted upward or downward at the end of each reporting period. In addition to the events described below which may affect a specific investment, the Company will take into account general market conditions when valuing the privately-held investments in its portfolio.

Absent the occurrence of any of these events or any significant change in general market conditions indicates generally that the fair value of the investment has not materially changed.

The fair value of a privately-held investment may be adjusted upward if:

a. there has been a significant subsequent equity financing provided by outside investors, at a valuation above the current value of the investee company, in which case the fair value of the investment is set to the value at which that financing took place; or

b. there have been significant corporate, political or operating events affecting the investee company that, in management's opinion, have a positive impact on the investee company's prospects and therefore its fair value. In these circumstances, the adjustment to the fair value of the investment will be based on management's judgment and any value estimated may not be realized or realizable.

   Such events include, without limitation:

   i. political changes in a country in which the investee company operates which, for example, reduce the corporate tax burden, permit mining where, or to an extent that, it was not previously allowed, or reduce or eliminate the need for permitting or approvals;

   ii. receipt by the investee company of environmental, mining, aboriginal or similar approvals, which allow the investee company to proceed with its project(s);

   iii. filing by the investee company of a National Instrument 43-101 technical report in respect of a previously non-compliant resource;

   iv. release by the investee company of positive exploration results, which either proves or expands their resource prospects; and

   v. important positive management changes by the investee company that the Company's management believes will have a very positive impact on the investee company's ability to achieve its objectives and build value for shareholders.

   In the circumstances described above under (i) through (v), or in circumstances where general market conditions so warrant it, an adjustment to the fair value of an investment will be based upon management's judgment and any value estimated may not be realized or realizable.

The fair value of a privately-held investment may be adjusted downward if:

a. there has been a significant subsequent equity financing provided by outside investors, at a valuation below the current value of the investee company, in which case the fair value of the investment is set to the value at which that financing took place;

b. the investee company is placed into receivership or bankruptcy;

c. based on financial information received from the investee company, it is apparent to the Company that the investee company is unlikely to be able to continue as a going concern; or

d. there have been significant corporate, political or operating events affecting the investee company that, in management's opinion, have a negative impact on the investee company's prospects and therefore its fair value. The amount of the change to the fair value of the investment is based on management's judgment and any value estimated may not be realized or realizable.

   Such events include, without limitation:

   i. political changes in a country in which the investee company operates which increases the tax burden on companies, which prohibit mining where it was previously allowed, which increases the need for permitting or approvals, etc.;

   ii. denial of the investee company's application for environmental, mining, aboriginal or similar approvals which prohibit the investee company from proceeding with its projects;

   iii. the investee company releases negative exploration results; and

   iv. changes to the management of the investee company take place which the Company believes will have a negative impact on the investee company's ability to achieve its objectives and build value for shareholders.

In the circumstances described above under (i) through (iv), or in circumstances where general market conditions so warrant it, an adjustment to the fair value of an investment will be based upon management's judgment and any value estimated may not be realized or realizable.

The resulting values for non-publicly traded investments may differ from values that would be realized if a ready market existed. In addition, the amounts at which the Company's privately-held investments could be disposed of currently may differ from the carrying value assigned.

(c) Cash and cash equivalents:

Cash and cash equivalents include cash on hand and short-term investments with remaining maturities of less than three months. Cash and cash equivalents include accrued interest on short-term investments.

(d) Restricted cash:

Restricted cash represents cash in the form of Guaranteed Investment Certificates ("GIC") deposited with the Company's bank as collateral for letters of guarantee provided by the bank.

The restricted cash underlying a GIC (or part thereof) is classified as current if the GIC (or part thereof) is expected to be released within one year, otherwise the restricted cash is classified as non-current.

(e) Revenue recognition:

Securities transactions are recorded on a settlement date basis. Realized gains and losses on disposal of investments and unrealized gains and losses in the value of investments are reflected in the consolidated statements of comprehensive loss and are calculated on an average cost basis. Upon disposal of an investment, previously recognized unrealized gains or losses are reversed, so as to recognize the full realized gain or loss in the period of disposition. All transaction costs associated with the acquisition and disposition of investments are expensed to the consolidated statements of comprehensive loss as incurred.

Interest and other income are recorded on an accrual basis.

Revenues from the sale of oil and natural gas are reported as sales revenue when management has determined that the oil and gas property is commercially viable.

Revenues from the sale of oil and natural gas prior to when an oil and gas property is commercially viable are netted against oil and gas properties and related expenditures, together with the associated operating expenses as the revenue is generated from a process bringing the property to the location and condition for its intended use. Revenues are recognized when the risk and rewards of ownership pass to the purchaser, including delivery of the product, the selling price is fixed or determinable and collectability is reasonably assured.

(f) Segment reporting:

Operating segments are defined as components of an enterprise about which separate financial information is available, that is evaluated regularly by management in deciding how to allocate resources and in assessing performance. The Company has the following reportable geographic segments: Colombia, Israel, Canada, United States, Argentina and Brazil.

(g) Foreign currency translation:

(i) Functional currency:

The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. Each entity in the Company's consolidated group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

(ii) Transactions and balances:

Transactions in foreign currencies are initially recorded in the functional currency at the rate prevailing at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the spot rate of exchange prevailing at the reporting date. All differences are taken to the statement of comprehensive loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date

of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. All exchange differences are recorded in the consolidated statement of comprehensive loss under operating, general, and administrative.

(iii) Translation of foreign operations:

The results and financial position of Brownstone's subsidiaries that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

1. Assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;

2. Revenue and expenses for each statement of comprehensive loss are translated at average monthly exchange rates; and

3. All resulting exchange differences are recognized as a separate component of equity as foreign currency translation reserve and as exchange differences on translation of foreign operations in other comprehensive loss in the consolidated statement of comprehensive loss.

The Company treats specific inter-company loan balances, which are not intended to be repaid in the foreseeable future, as part of its net investment which is recorded as an exchange difference on translation of foreign operations in other comprehensive loss in the consolidated statement of comprehensive loss.

When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognized in the profit or loss as part of the gain or loss on sale. Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

(h) Non-monetary transactions:

Transactions in which shares or other non-cash consideration are exchanged for assets or services are valued at the fair value of the assets or services involved.

(i) Income taxes:

(i) Current income tax:

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the end of the reporting period. Current tax assets and current tax liabilities are only offset if a legally enforceable right exists to set off the amounts, and the intention is to settle on a net basis, or to realize the asset and settle the liability simultaneously. Current income tax relating to items recognized directly in equity is recognized in equity and not in the statement of comprehensive loss.

(ii) Deferred tax:

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.

Deferred tax liabilities ("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 creates a valuation allowance to the extent that it considers deductible temporary differences, the carry forward of unused tax credits and unused tax losses cannot be utilized.

DTA and DTL are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date. DTA and DTL are not offset unless a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

(j) Stock-based compensation:

Employees (including officers), directors and consultants of the Company receive remuneration in the form of stock options for rendering services to the Company ("equity-settled transactions"). Stock options granted during the year 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.

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. The cost of equity-settled transactions is recognized, together with a corresponding increase in contributed surplus, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employee becomes fully entitled to the award ("the vesting date").

The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. The Company records compensation expense and credits contributed surplus for all stock options granted which represents the movement in cumulative expense recognized as at the beginning and end of that period. Any consideration received on the exercise of stock options is credited to share capital.

Where the terms of an equity-settled award are modified, the minimum expense recognized in compensation expense is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. This includes any award where non-vesting conditions within the control of either the entity or the

counterparty are not met. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of diluted earnings (loss) per share.

(k) Interest expense:

Interest expense is recorded on an accrual basis.

(l) Earnings (loss) per share:

Basic earnings (loss) per common share is determined by dividing profit (loss) for the period attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share is calculated in accordance with the treasury stock method and is based on the weighted average number of common shares and dilutive common share equivalents outstanding. This method assumes that any proceeds received from in-the-money options and warrants would be used to buy common shares at the average market price for the period.

(m) Financial assets other than investments at fair value:

Financial assets which are managed to collect contractual cash flows made up of principal and interest are designated as at amortized cost. All other financial assets are designated at fair value through profit and loss. All financial assets are recognized initially at fair value plus, in the case of financial assets designated at amortized cost directly attributable transaction costs.

Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with changes in fair value recognized in the statement of comprehensive loss. Financial assets at amortized cost are measured at initial cost plus interest calculated using the effective interest rate method less cumulative repayments and cumulative impairment losses.

A financial asset is derecognized when the rights to receive cash flows from the asset have expired, or the Company has transferred substantially all the risks and rewards of the asset. The Company assesses at each reporting date whether there is any objective evidence that a financial asset is impaired. For amounts deemed to be impaired the impairment provision is based upon the expected loss.

(n) Financial derivatives – options and warrants

A financial derivative such as warrants and options which will be settled with the entity's own equity instruments will be designated as an equity instrument if the derivative is to acquire a fixed number of the entity's own equity instruments for a fixed amount of Canadian dollars. A financial derivative will be considered as a financial liability at fair value through profit or loss if it is to acquire either a variable number of equity instruments or the exercise price is not fixed.

Where the exercise price is in a foreign currency and the options and warrants were not offered pro rata to all of its existing owners of the same class of its own non-derivative equity

instruments then this instrument will be classified as a financial liability at fair value through profit or loss.

(o) Provisions:

(i) General:

Provisions are recognized when (a), the Company has a present obligation (legal or constructive) as a result of a past event which is independent of future action by the Company, and (b), it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are discounted using a current pre tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

(ii) Asset retirement obligation:

Asset retirement obligation is the present value of estimated costs to restore operating locations in accordance with regulations and laws as defined by each oil and gas license.

(p) Financial liabilities:

All financial liabilities are designated as at amortized cost except for financial derivatives and any financial liabilities from inception classified as at fair value through profit or loss. All financial liabilities are recognized initially at fair value plus directly attributable transaction costs except for those designated at fair value through profit and loss. Financial liabilities at fair value through profit or loss are carried in the statement of financial position at fair value with changes in fair value recognized in the statement of comprehensive loss. Financial liabilities at amortized cost are measured at initial cost plus interest calculated using the effective interest rate method less payments.

(q) Offsetting of financial instruments:

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

(r) Cost of private placement financings:

Incremental costs incurred in respect of raising capital through private placements are charged against equity proceeds raised.

Critical accounting estimates:

The preparation of the interim 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 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.

<u>Valuation of privately-held investments:</u>

The method used by the Company to value its privately-held investments (being securities of issuers that are not public) is described under "Significant accounting policies" elsewhere in this MD&A. 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 ending September 30, 2011, the Company had no adjustments (three months ended September 30, 2010 – unrealized losses of $469,700) on private company investments.

<u>Estimate of recoverable fair value on exploration and evaluation assets:</u>

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, 2011 and 2010, the Company had no wrote-down on its oil and gas properties and related expenditures.

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.

Deferred tax liabilities ("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 deductible temporary differences, the carry forward of unused tax credits and unused tax losses cannot be utilized.

As at September 30, 2011, the Company has approximately $937,000 (June 30, 2011 - $961,600; July 1, 2010 - $1,001,000) of Canadian resource deductions and $22,463,500 (June 30, 2011 - $22,586,500; July 1, 2010 - $23,076,000) of foreign resource deductions available that have an unlimited carry-forward period to reduce future years' income for tax purposes, the tax effect of which has not been fully recorded in the accounts.

As at September 30, 2011, the Company has approximately $3,037,400 (June 30, 2011 - $2,400,900; July 1, 2010 - $73,100) of Canadian non-capital losses available to reduce future years' income for tax purposes, the tax effect of which has not been fully recorded in the accounts.

Management determined, based upon expectations for future taxable income, that it believes that it is more likely than not 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.

There were no options granted during the three months ended September 30, 2011.

The following options were granted during the year ended June 30, 2011:

Date granted	Options granted	Exercise price	Expiry
September 21, 2010	1,195,000	$ 0.51	September 20, 2015
December 17, 2010	500,000	0.80	December 16, 2015
February 17, 2011	300,000	0.95	February 17, 2013
March 30, 2011	1,365,000	1.20	March 29, 2016
	3,360,000		

The fair value of the options granted during the year ended June 30, 2011 was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

Black-Scholes assumptions used	
Expected volatility	109.0% to 120.9%
Expected dividend yield	0%
Risk-free interest rate	1.7% to 2.3%
Expected option life in years	2.0 to 4.5 years
Expected forfeiture rate	2.7% to 4.0%
Fair value per stock option granted on September 21, 2010	$ 0.37
Fair value per stock option granted on December 17, 2010	$ 0.59
Fair value per stock option granted on February 17, 2011	$ 0.54
Fair value per stock option granted on March 30, 2011	$ 0.89

During the year ended June 30, 2011, pursuant to the exercise of broker warrants, 590,245 purchase warrants were issued exercisable at $0.75 per share and expiring on April 13, 2012. The purchase warrants were valued using the Black-Scholes option pricing model with the following assumptions: expected volatility of 96.9%; dividend yield of 0%; risk-free interest rate of 3.00%; and an expected life of 1.5 year. The value assigned to the purchase warrants was $27,942.

During the year ended June 30, 2011, the Company closed a brokered private placement financing and issued 15,131,579 purchase warrants and 2,118,421 broker warrants. The purchase warrants and broker warrants are exercisable at $1.25 per share and expire on September 11, 2012. The fair value of the purchase warrants were estimated at the date of issue using the Black-Scholes option pricing model with the following assumptions:

Black-Scholes assumptions used for stock-based compensation expense	
Expected volatility	**83.3%**
Expected dividend yield	**0.0%**
Risk-free interest rate	**3.0%**
Expected warrant life in years	**1.5**
Fair value per warrant issued	**$ 0.275**

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. During the three months ended September 30, 2011 and 2010, 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:

Subsequent to September 30, 2011, the Company granted 2,180,000 options exercisable at $0.40 per share and expiring on October 10, 2016.

As at November 29, 2011, 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:

Common shares	Number
Outstanding	**129,794,289**
Issuable under options	**9,150,080**
Issuable under warrants	**23,129,806**
Issuable under broker warrants (a)	**3,466,010**
Total diluted common shares	**165,540,185**

(a) Of the 3,466,010 broker warrants, 1,347,589 broker warrants are each exercisable for one unit of the Company at $0.55 per unit on or before April 13, 2012. Upon exercise, each unit will be comprised of one common share of the Company and one-half common share purchase warrant of the Company, with each whole common share purchase warrant entitling the holder to acquire one common share of the Company at a price of $0.75 per share on or before April 13, 2012.

Of the 3,466,010 broker warrants, 2,118,421 broker warrants are each exercisable for one common share of the Company at $1.25 per share on or before September 11, 2012.

Refer to note 10 of the notes to the interim financial statements as at and for the three months ended September 30, 2011 for details of the Company's share capital as at September 30, 2011.

Pending Transaction:

The Company qualified for and bid for onshore land blocks offered by the ANP in Brazil's Round 8 land auction held on November 28 and 29, 2006 ("Round 8 Bid"). Brownstone and its partners in the Round 8 Bid, Canacol and W.Washington, were successful in winning and being awarded 5 separate blocks, each block totaling 180 square kilometers of exploration lands ("Round 8 Bid Lands") in the Tucano Basin which lies directly West of the Reconcova Basin. However, the Round 8 Bid is the subject of a court injunction granted in Brasilia against the ANP. The grounds for the injunction are that the restriction for any one exploration & production company to purchase more than 4 blocks of

land in any one area in any given Bid Round of land is unconstitutional. As of the date of this MD&A, the court injunction had yet to be lifted and Brownstone and its partners in the Round 8 Bid have no information indicating that their Round 8 Bid Lands will not be retained by them.

Additional Information:

Additional information relating to Brownstone may be found on the Company's website at www.brownstoneenergy.com or under the Company's profile on SEDAR at www.sedar.com.