# Brownstone Energy Inc.

## Management's Discussion and Analysis

**For the quarter ended: September 30, 2012**

**Date of report: November 27, 2012**

This management's discussion and analysis of the financial condition and results of operation ("MD&A") of Brownstone Energy Inc. ("Brownstone" or the "Company") should be read in conjunction with Brownstone's unaudited interim condensed consolidated financial statements ("interim consolidated statements") and notes thereto as at and for the three months ended September 30, 2012 and the annual consolidated financial statements as at and for the year ended June 30, 2012. The same accounting policies and methods of computation were followed in the preparation of the interim consolidated statements as were followed in the preparation and described in note 3 of the annual consolidated financial statements as at and for the year ended June 30, 2012.

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

### Caution Regarding Forward-Looking Information:

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

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

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

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.

## About Brownstone:

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. Its common shares are publicly traded on the TSX Venture Exchange ("TSXV") under the symbol "BWN" and on the OTCQX under the symbol "BWSOF".

## Summary:

- As at September 30, 2012, the Company has working capital of $13,614,107 as compared to working capital of $20,793,675 as at June 30, 2012, a decrease of 34.5%, primarily due to the expenditures on exploration and evaluation assets during the three months ended September 30, 2012.

- As at September 30, 2012, exploration and evaluation assets increased by 10.1% to $49,681,931 as compared to $45,141,148 as at June 30, 2012. The increase includes net exploration and evaluation expenses of $6,111,873 offset by a foreign currency translation loss of $1,571,090.

## Going concern uncertainty:

The Company incurred a loss of $1,095,691 for the three months ended September 30, 2012 and had an accumulated deficit of $54,218,028. Although as at September 30, 2012, it had positive working capital, the balance is not sufficient to fund Brownstone's budgeted capital expenditures on its exploration and evaluation properties for the twelve months ended September 30, 2013. Brownstone relies primarily on equity financings to finance its operations. It only recently began generating revenue from the sale of crude oil production and is not expected to generate sufficient cash flow from oil production revenue to fund its operations for the foreseeable future. Failure to meet its funding commitments with its partners may result in the loss of the Company's oil and gas interests.

The Company's ability to continue as a going concern will depend upon its ability to raise capital from external sources to fund its oil and gas activities commitments as they become due. Brownstone will have to seek debt and/or equity financing and/or pursue sale transactions for its properties, all of which will be dependent upon factors outside of Brownstone's control, such as the strength of crude oil prices and investor confidence in securities of oil exploration and development companies generally, and may not be feasible alternatives. There are no assurances that these sources of capital will be available to the Company when required or on acceptable terms and, if they prove to be unavailable, the Company may be forced to cease operations.

## Exploration and evaluation assets:

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

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

| | Colombia (a) | Israel (b) | USA (c) | Canada | Argentina (d) | Total |
|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ |
| **Balance at July 1, 2011** | 20,009,680 | 1,930,847 | 15,180,462 | 1,074,822 | 3,857,200 | 42,053,011 |
| Net additions | 13,309,405 | 2,575,117 | 1,170,351 | 41,935 | - | 17,096,808 |
| Disposals | - | - | (3,642) | - | - | (3,642) |
| Impairment of exploration and evaluation assets | - | - | (13,288,299) | - | (3,004,500) | (16,292,799) |
| Foreign currency translation | 1,425,970 | 108,153 | 587,247 | - | 166,400 | 2,287,770 |
| **Balance at June 30, 2012** | 34,745,055 | 4,614,117 | 3,646,119 | 1,116,757 | 1,019,100 | 45,141,148 |
| Net additions | **3,713,524** | **1,566,899** | **817,740** | **13,710** | **-** | **6,111,873** |
| Foreign currency translation | **(1,247,354)** | **(180,030)** | **(108,306)** | **-** | **(35,400)** | **(1,571,090)** |
| **Balance at September 30, 2012** | **37,211,225** | **6,000,986** | **4,355,553** | **1,130,467** | **983,700** | **49,681,931** |

(a) Colombia:

During the three months ended September 30, 2012, the Company spent $3,713,524 (three months ended September 30, 2011 - $2,972,870) on exploration and evaluation of the blocks in Colombia, net of $1,701,390 (three months ended September 30, 2011 - $553,045) in 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 Colombian blocks as at September 30, 2012 and June 30, 2012 is as follows:

| | Canaguaro Block (i) | Block 21 (ii) | Block 27 (iii) | Block 36 (iv) |
|---|---|---|---|---|
| Private participation interest | 25% | 24.75% | 34.25% | 14% |
| Increased costs assumed | 31.25% | 50% | 50% | 20% |
| Increased participation interest | 25% | 24.75% | 45.275% | 18.2% |

(i) Canaguaro: The Company has a 25% private participating interest and is required to pay 25% of any costs relating to the wells on the Block. The Company also pays a 6% overriding royalty, proportional to its interest, to Concorcio Canaguaro on its share of production (in addition to 1.5% royalties payable to the Agencia Nacional de Hidrocarburos ("ANH")), and a one-time success fee to Concorcio Canaguaro of up to US$1,000,000, payable following the completion of the first 12 months of 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 ("BOPD").

Canaguay-1 Well - Following several workovers to replace pump components and treatment to remove a buildup of asphaltenes, the Canaguay-1 well has been put back on production and continues to produce approximately gross 600 BOPD with a watercut of approximately 62%.

Canaguay-2 Well – In the second quarter of 2012, Brownstone and its partners received approval from the ANH for the Evaluation Program at the Canaguaro Block. The commitment under the Evaluation Program is to drill another well by June 15, 2013. However, the Company and partners are still waiting the receipt of environment approvals from the Colombian government.

(ii) Block 21: Under an amending agreement dated February 28, 2012 to the original participation agreement, the Company's obligation to fund Phase I work commitments is limited to US$3,875,000. Upon completion of the two Phase I exploration wells, the Company has an option to share in production revenue to a maximum of 24.75% by contributing in aggregate 50% of all Phase I costs (inclusive of US$3,875,000) and assuming 24.75% of the future work obligations under the exploration and production contract. The Company has paid US$750,000 under the amending agreement.

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

Flami-1 Well – Subsequent to the completion of the initial testing, the Flami-1 well was shut-in until August 18, 2012 when regulatory approval to put the well back on production for long term testing was received. The well has produced continuously since that date with an average of gross 800 BOPD at a 60% watercut.

Flami-2 Well – The Company and its partners have developed plans to drill the Flami-2 well into the Flami structure to continue development of the field and further evaluate the production potential of the Mirador and Une oil bearing formations encountered in the Flami-1 well. Timing of the well is subject to seasonal access and rig availability.

Mani-1 Exploration Well - as part of the extended test following the oil discovery, the operator has observed that total fluid production has continued to increase, with the watercut also continuing to increase and now exceeding 85% of production fluids. As a result the well was shut-in on April 23, 2012 and has remained shut-in until the date of this MD&A, the operator is now investigating whether: a) the cement job from the original completion has failed to hold properly causing water to seep from lower zones; or b) if the water is being produced from the target reservoir. The operator has decided to suspend production of the well until the drilling of the Flami-2 well is completed, at which time the operator will review the option of carrying out another remedial cement job.

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

The Company has been advised by the operator of Block 36, that it has made an application to the Agencia Nacional de Hidrocarburos for an extension of the Phase 1 exploration deadline and is still awaiting a decision on that application.

(b) Israel:

As at September 30, 2012, the Company has the following participating interests in Israel:

| | **Gabriella Block (i)** | **Yitzhak Block (ii)** | **Samuel Block (iii)** |
|---|---|---|---|
| Participating Interest | 15% | 15% | 6.75% |

(i) Gabriella Block: The partners of the Gabriella Block have engaged Halliburton affiliate, Universal Energy Services, to act as project manager for the drilling of the Gabriella well which was scheduled to begin drilling operations on or about December 1, 2012. Subsequently, a drilling extension was granted on the block by the Ministry of Energy and Water of the State of Israel, with a new spud date of June 30, 2013. Work towards finalizing the drilling location, conceptual well design, and rig selection is proceeding. In July 2012, the Company and its partners executed a detailed drilling contract with Noble International Ltd. to drill the planned well. The agreement provides for the drilling of the Gabriella licence by the Noble Homer Farrington semi-submersible drilling rig prior to the government-regulated spud date of June 30, 2013.

(ii) Yitzhak Block: The partners of the Yitzhak Block have engaged AGR Energy AS of Norway, under its affiliate, AGR Well Management Limited, to act as operator for the drilling of the Yitzhak well which was scheduled to begin drilling operations on or about December 1, 2012. Subsequently, a drilling extension was granted on the block by the Ministry of Energy and Water of the State of Israel, with a new spud date of October 30, 2013. Work towards finalizing the drilling location, conceptual well design, and rig selection is proceeding. The Company has been informed by the operator of the Block that there are currently no rigs available to drill the well within the required time frame and therefore drilling will most likely be delayed, subject to the approval of the Israeli government.

(iii) Samuel Block: The partners of the Samuel Block have engaged Halliburton affiliate, Universal Energy Services, to act as project manager for the drilling of the Samuel well which was scheduled to begin drilling operations on or about October 1, 2012. Subsequently, a drilling extension has been granted on the block by the Ministry of Energy and Water of the State of Israel, with a new spud date of April 30, 2013. Work towards finalizing the drilling location, conceptual well design, and rig selection is proceeding. The Company has been informed by the operator of the Block that there are currently no rigs available and therefore drilling will most likely be delayed, subject to the approval of the Israeli government.

(c) USA:

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

(d) Argentina:

In July 2007, the Company signed a participation agreement with Petrolifera Petroleum Limited ("Petrolifera"), whereby Brownstone has earned a 25% interest in Petrolifera's Vaca Mahuida Block in the Province of Rio Negro, Argentina. Under the terms of the participation agreement, Brownstone is required to fund 50% of the costs to be incurred in the conduct of the work program on the property. During the year ended June 30, 2011, Petrolifera's interests and operatorship in the block were acquired by Gran Tierra Energy Inc.

## Investments:

The fair value and cost of investments are as follows:

| | Fair Value | Cost |
|---|---|---|
| **September 30, 2012** | **$ 2,984,003** | **$ 13,750,659** |
| June 30, 2012 | 2,771,469 | 13,250,659 |

As at September 30, 2012, the original cost of investments exceeded fair value by $10,766,656 as compared to $10,479,190 as at June 30, 2012. The decrease for the three months ended September 30, 2012 was due to the net change in unrealized losses on investments of $287,466.

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

## Results of Operations

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

| | Quarter ended | | | |
|---|---|---|---|---|
| | **September 30, 2012** | June 30, 2012 | March 31, 2012 | December 31, 2011 |
| Net investment gains (losses) | **$ (287,466)** | $ (1,361,788) | $ (3,848,424) | $ 2,154,987 |
| Profit (loss) for the period | **(1,095,691)** | (2,688,493) | (21,915,937) | 893,858 |
| Total comprehensive loss for the period | **(2,737,183)** | (1,901,522) | (22,730,621) | (53,707) |
| Earnings (loss) per share based on profit (loss) for the period – basic and diluted | **(0.01)** | (0.02) | (0.17) | 0.01 |
| | September 30, 2011 | June 30, 2011 | March 31, 2011 | December 31, 2010 |
| Net investment gains (losses) | $(2,563,599) | $ (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 and diluted | (0.03) | (0.02) | (0.01) | 0.03 |

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

### Three months ended September 30, 2012 and 2011:

For the three months ended September 30, 2012, the Company had no disposal of investments as compared to generating net realized losses of $191,311 for the three months ended September 30, 2011. For the three months ended September 30, 2011, the Company realized net losses from the disposition of a portion of its holdings in Dejour Energy Inc.

For the three months ended September 30, 2012, the Company recorded a net change in unrealized losses on investments of $287,466 as compared to $2,372,268 for the three months ended September 30, 2011. Of the net change in unrealized losses in the three months ended September 30, 2012, all was due to the net write-down to market on the Company's investments. Of the net unrealized losses in the three months ended September 30, 2011, $2,554,446 was due from the reversal of net unrealized gains on the disposal of investments offset by net write-up to market on the Company's investments of $182,178.

For the three months ended September 30, 2012, the Company recorded interest and other income of $48,458 as compared to $85,173 for the three months ended September 30, 2011. Interest income is primarily composed of interest income earned on investments in bankers' acceptances and cash deposits. In the current period, the cash deposits were much lower which decreases the interest earned.

For the three months ended September 30, 2012, operating, general and administrative expenses decreased by $115,679 to $720,759 from $836,438 for the three months ended September 30, 2011. The decrease was primarily due to a decrease in stock-based compensation expense offset by a decrease in foreign exchange gain as discussed below.

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

| | | **2012** | | 2011 |
|---|---|---|---|---|
| Salaries, consulting and administrative fees | **$** | **360,575** | $ | 341,778 |
| Other office and general | | **198,552** | | 190,566 |
| Stock-based compensation expense (a) | | **127,972** | | 387,851 |
| Professional fees | | **51,710** | | 63,189 |
| Travel and promotion | | **15,316** | | 7,964 |
| Shareholder relations, transfer agent and filing fees | | **11,433** | | 28,198 |
| Other employment benefits | | **6,745** | | 14,114 |
| Foreign exchange gain (b) | | **(51,544)** | | (197,222) |
| | **$** | **720,759** | $ | 836,438 |

(a) Stock-based compensation expense decreased by $259,879 for the three months ended September 30, 2012 as compared to the three months ended September 30, 2011. The decrease was due to a decrease in the number of stock options which vested during the current period as compared to the prior year period. There were no stock options granted during the current or prior year period. Stock options granted in prior years vest at three-month intervals over 18 months and are accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value of these options is estimated at the date of grant using the Black-Scholes option pricing model, and expensed over the vesting periods based on the graded method. Unvested forfeited stock options are not expensed during the period.

(b) Foreign exchange gain decreased by $145,678 for the three months ended September 30, 2012 as compared to the three months ended September 30, 2011 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 as compared to the three months ended September 30, 2011.

For the three months ended September 30, 2012, the Company recorded an income tax expense of $135,924 as compared to $28,462 for the three months ended September 30, 2011. The income tax expense is due to the recording of a 3.5% withholding tax in Colombia on sales of crude oil and an accrual of minimum income tax payable due in Colombia.

Loss for the three months ended September 30, 2012 was $1,095,691 ($0.01 per share) as compared to $3,343,326 ($0.03 per share) for the three months ended September 30, 2011.

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

## Cash Flows
## Three months ended September 30, 2012 and 2011:

During the three months ended September 30, 2012, the Company used cash of $1,286,099 in operating activities as compared to $282,008 during the three months ended September 30, 2011.

During the three months ended September 30, 2012, the Company had no cash transactions in financing activities as compared to generating cash of $137,809 during the three months ended September 30, 2011. During the three months ended September 30, 2011, the cash generated was from a decrease of $137,809 from due from brokers during the three months ended September 30, 2011.

During the three months ended September 30, 2012, net cash used in investing activities was $6,139,557 as compared to cash generated of $1,201,083 during the three months ended September 30, 2011. During the three months ended September 30, 2012, the Company spent cash on expenditures on exploration and evaluation assets of $5,609,983 as compared to cash expenditures of $2,961,266 during the three months ended September 30, 2011, an increase that continues to reflect the Company's increased oil and gas activities, primarily in Colombia and Israel. During the three months ended September 30, 2012, the Company had proceeds from dispositions of investments of nil as compared to $87,902 during the three months ended September 30, 2011. During the three months ended September 30, 2012, the Company purchased $500,000 of investments as compared to $50,000 during the three months ended September 30, 2011. During the three months ended September 30, 2012, the Company had an increase in restricted cash of $49,185 offset by an unrealized foreign exchange loss of $19,611 as compared to decreased of $4,124,447 from the release of restricted cash following the return by the Agencia Nacional de Hidrocarburos ("ANH"), a Colombian government agency, of 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 Guarantee ("PSG") by Export Development Canada ("EDC"), a federal government agency, to the Company's bank in support of other letters of guarantee given to ANH.

For the three months ended September 30, 2012, the Company had a net decrease in cash and cash equivalents of $7,425,656 as compared to a net increase in cash and cash equivalents of $1,056,884 for the three months ended September 30, 2011. For the three months ended September 30, 2012, the Company also had a loss from the exchange rate changes on its foreign operations' cash balances of $70,402, leaving a cash and cash equivalents balance of $10,700,948 as at September 30, 2012 as compared to an exchange loss of $38,607, leaving a cash and cash equivalents balance of $30,852,083 as at September 30, 2011.

## Segmented information:

Reporting segments are define as components of an enterprise about which separate financial information is available, that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. All of the Company's operations relate to direct and indirect investments in the oil and gas sector. The Company's significant segments include six distinct geographic areas: Colombia, Israel, Canada, United States, Argentina and Brazil. There were no changes in the reportable segments since June 30, 2012.

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

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

| | **Three months ended September 30, 2012** | | **As at September 30, 2012** | | |
|---|---|---|---|---|---|
| | **Interest and other income** | **Loss for the period** | **Exploration and evaluation assets** | **Other assets** | **Total assets** |
| Canada and other | **$ 35,166** | **$ 979,255** | **$ 1,130,467** | **$ 14,105,884** | **$ 15,236,351** |
| Colombia | **13,292** | **105,020** | **37,211,225** | **1,339,240** | **38,550,465** |
| Israel | **-** | **11,416** | **6,000,986** | **7,027** | **6,008,013** |
| United States | **-** | **-** | **4,355,553** | **23,173** | **4,378,726** |
| Argentina | **-** | **-** | **983,700** | **20,550** | **1,004,250** |
| Brazil | **-** | **-** | **-** | **136,418** | **136,418** |
| | **$ 48,458** | **$ 1,095,691** | **$ 49,681,931** | **$ 15,632,292** | **$ 65,314,223** |

The following is segmented information for the three months ended September 30, 2011 and as at June 30, 2012:

| | Three months ended September 30, 2011 | | As at June 30, 2012 | | |
|---|---|---|---|---|---|
| | Interest and other income | Loss for the period | Exploration and evaluation assets | Other assets | Total assets |
| Canada and other | $ 79,625 | $ 3,264,190 | $ 1,116,757 | $ 20,288,293 | $ 21,405,050 |
| Colombia | 5,548 | 66,104 | 34,745,055 | 1,779,469 | 36,524,524 |
| Israel | - | 13,032 | 4,614,117 | 177,012 | 4,791,129 |
| United States | - | - | 3,646,119 | 37,022 | 3,683,141 |
| Argentina | - | - | 1,019,100 | 84,666 | 1,103,766 |
| Brazil | - | - | - | 142,662 | 142,662 |
| | $ 85,173 | $ 3,343,326 | $ 45,141,148 | $ 22,509,124 | $ 67,650,272 |

### Liquidity and capital resources:

| **Consolidated statements of financial position highlights** | **September 30, 2012** | June 30, 2012 |
|---|---|---|
| Cash and cash equivalents | **$ 10,700,948** | $ 18,197,006 |
| Investments, at fair value | **2,984,003** | 2,771,469 |
| Exploration and evaluation assets | **49,681,931** | 45,141,148 |
| Total assets | **65,314,223** | 67,650,272 |
| Total liabilities | **1,424,030** | 1,150,868 |
| Share capital, warrants and broker warrants, contributed surplus | **120,678,452** | 120,550,480 |
| Foreign currency translation reserve | **(2,570,231)** | (928,739) |
| Deficit | **(54,218,028)** | (53,122,337) |
| Working Capital | **13,614,107** | 20,793,675 |

Accounts payable and accrued liabilities increased by $174,989 to $1,325,857 as at September 30, 2012 as compared to $1,150,868 as at June 30, 2012. As at September 30, 2012, the accounts payable and accrued liabilities included $881,695 for exploration and evaluation cash calls as compared to $376,480 (which was paid during the three months ended September 30, 2012). As at September 30, 2012, included in accounts payable and accrued liabilities is $320,891 for a Colombian equity tax as compared to $428,493 as at June 30, 2012. The Colombian government implemented a new equity tax in December 2010, which Brownstone is required to pay based on the net equity of its Colombian branch office, subject to certain adjustments.

As at September 30, 2012, the Company had accrued income taxes payable of $98,173 (2011 – nil) for the alternative minimum tax payable in Colombia. The income tax payable in Colombia is calculated annually at a rate of 3% of the Company's net worth held at the end of the prior year with certain adjustments. The income tax payable recorded as at September 30, 2012 may differ from the actual amount due for the tax year ended December 31, 2012 when the Company files its tax return in Colombia.

The Company's cash and cash equivalents and investments as at September 30, 2012 are sufficient to meet the Company's current financial obligations. As at June 30, 2012, the Company had working capital of $13,614,107 as compared to working capital of $20,793,675 as at June 30, 2012, a decrease which was primarily due to the expenditures on exploration and evaluation assets and purchase of investments totalling $500,000.

The Company has committed and is required to meet all of its drilling and related expenditures as they become due to maintain its oil and gas interests (see "Exploration and evaluation assets" section). These obligations are not fixed and cannot be pre-determined with certainty.

The Company is currently generating net operating revenue from the sale of crude oil produced from two of its Colombian Blocks, however, its existing cash reserves and anticipated ongoing revenue from Colombia production (based on current production levels and crude oil prices, both of which may decline) will not be sufficient to fund planned capital expenditures in Colombia and Israel through to September 2013. In order to meet its' operating and capital expenditure obligations as they become due, and until such time, if any, that the Company generates sufficient cash from the sale of crude oil to do so, Brownstone will have to rely on external sources of capital. The Company expects to raise additional funds through debt and/or equity financings to meet its obligations and will consider, where warranted, strategic dispositions of certain of its interests in order to reduce its capital expenditure requirements). The Company's ability to access the debt and equity markets when required will depend upon factors beyond its control, such as economic and political conditions that may affect the capital markets generally and the oil and gas industry specifically, including conditions pertaining to the countries in which it operates. The inability of the Company to raise sufficient capital to fund its operations and growth may result in the loss of some or all of the Company's interests and accordingly could have a material adverse effect on the Company's business, financial condition, and results of operations, and its ability to continue as a going concern.

The Company has no long-term debt.

As at September 30, 2012, the Company had restricted cash totaling $594,155 (US$604,000) of which $49,185 (US$50,000) was current, as collateral to the Royal Bank of Canada ("RBC") for a letter of guarantee issued by RBC for Blocks in Colombia. As at June 30, 2012, the Company had restricted cash totaling $564,581 (US$554,000). The restricted cash is held in Guaranteed Investment Certificates ("GICs"), which are renewed on a monthly basis at the prevailing interest rate (0.02% per annum as at September 30, 2012 and June 30, 2012.

As at September 30, 2012 and June 30, 2012, the Company also has US$6,834,883 PSGs (from EDC) as collateral for letters of guarantee issued by RBC. 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.

Subsequent to September 30, 2012, the ANH released US$1,738,883 of the letters of guarantee and as a result, RBC released its letter of guarantee and the EDC released its PSG associated with the letter of guarantee.

## Investor relations:

During the three months ended September 30, 2012, 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:

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

| Type of expense | 2012 | 2011 |
|---|---|---|
| Salaries and consulting fees | **$ 199,986** | $ 234,188 |
| Other short-term benefits | **5,798** | 12,137 |
| Stock-based compensation expense | **88,301** | 279,272 |
| | **$ 294,085** | $ 525,597 |

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, 2012, there were no options granted to related parties.

During the year ended June 30, 2012, the Company granted 1,850,000 options to directors and officers of the Company, with an exercise price of $0.40 per share and expiring on October 10, 2016.

## Off-Balance sheet arrangements:

As at September 30, 2012, the Company has indemnified EDC for the full amount of the US$6,834,883 PSGs provided by the EDC. See "Liquidity and capital resources" for additional information regarding this contingent liability.

## Management of capital:

There were no changes in the Company's approach to capital management during the three months ended September 30, 2012. The Company's capital includes equity comprised of share capital, warrants and broker warrants, contributed surplus, foreign currency translation reserve, and deficit. To date, the Company has not declared any cash dividends to its shareholders as part of its capital management program. The Company's current capital resources are sufficient to discharge its liabilities as at September 30, 2012.

## Risk management:

(a) Market risk:

There were no changes in the way the Company manages market risk during the three months ended September 30, 2012. 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, 2012 from a change in the closing bid price of the Company's investments with all other variables held constant as at September 30, 2012:

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

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 price | Decrease in net after-tax loss from % increase in closing bid price | Increase in net after-tax loss from % decrease in closing bid price |
|---|---|---|
| 2% | $ 170,120 | $ (170,120) |
| 4% | 340,239 | (340,239) |
| 6% | 510,359 | (510,359) |
| 8% | 680,479 | (680,479) |
| 10% | 850,599 | (850,599) |

(b) Currency risk:

The Company presently holds funds in Canadian dollars but a significant amount of its costs are denominated in U.S. dollars, Colombian pesos, and Argentinean pesos. The Company does not engage in any hedging activities to mitigate its foreign exchange risk.

A change in the foreign exchange rate of the Canadian dollar versus another currency may increase or decrease the value of the Company's financial instruments. The Company does not hedge its foreign currency exposure.

The following assets and liabilities were denominated in foreign currencies:

| | **September 30, 2012** | June 30, 2012 |
|---|---|---|
| Denominated in U.S. dollars: | | |
| Cash and cash equivalents | **$ 217,332** | $ 2,066,666 |
| Restricted cash | **594,155** | 564,581 |
| Prepaids and receivables | **1,265,973** | 888,304 |
| Exploration and evaluation assets | **48,551,464** | 44,024,390 |
| Accounts payable and accrued liabilities | **(1,010,059)** | (965,440) |
| Net assets denominated in U.S. dollars | **49,618,865** | 46,578,501 |
| Denominated in Brazilian reals: | | |
| Cash and cash equivalents | **136,418** | 142,662 |
| Net assets denominated in Brazilian reals | **136,418** | 142,662 |
| Denominated in Argentinean pesos: | | |
| Cash and cash equivalents | **209** | 63,639 |
| Prepaids and receivables | **20,341** | 21,027 |
| Net assets denominated in Argentinean pesos | **020,550** | 84,666 |
| Denominated in Colombian pesos: | | |
| Cash and cash equivalents | **79,386** | 902,211 |
| Income taxes payable | **(98,173)** | - |
| Net assets denominated in Colombian pesos | **(18,787)** | 902,211 |

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the three months ended September 30, 2012 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, 2012:

| **Percentage change in U.S. dollar exchange rate** | **Decrease in total comprehensive loss from an increase in % in the U.S. dollar exchange rate** | **Increase in total comprehensive loss from a decrease in % in the U.S. dollar exchange rate** |
|---|---|---|
| **2%** | **$ 729,397** | **$ (729,397)** |
| **4%** | **1,458,795** | **(1,458,795)** |
| **6%** | **2,188,192** | **(2,188,192)** |
| **8%** | **2,917,589** | **(2,917,589)** |
| **10%** | **3,646,987** | **(3,646,987)** |

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the year ended June 30, 2012 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, 2012:

| Percentage change in U.S. dollar exchange rate | Decrease in total comprehensive loss from an increase in % in the U.S. dollar exchange rate | Increase in total comprehensive loss from a decrease in % in the U.S. dollar exchange rate |
|---|---|---|
| 2% | $ 684,704 | $ (684,704) |
| 4% | 1,369,408 | (1,369,408) |
| 6% | 2,054,112 | (2,054,112) |
| 8% | 2,738,816 | (2,738,816) |
| 10% | 3,423,520 | (3,423,520) |

## 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.

## Changes in Accounting Policies:

There were no changes to the Company's accounting policies since June 30, 2012. Details of the Company's significant accounting policies can be found in Note 3 to the Company's annual consolidated financial statements as at and for the year ended June 30, 2012.

## Critical accounting estimates:

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

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

Valuation of privately-held investments:

The 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 ended September 30, 2012 and 2011, the Company had no adjustments to fair value of its private company investments.

Estimate of recoverable fair value on exploration and evaluation assets:

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

At each reporting period, the Company's management reviews the status of all of its exploration properties, taking into account all of the factors noted above, in order to make an estimate of the recoverable value of each property. When management believes that the value of a property has been impaired, the Company will write down the value of the property to management's estimate of its recoverable value. As well, if the Company determines that an exploration project is not viable due to the risks described above or to unsatisfactory drill results, the Company will write-off the carrying value of the property. During the three months ended September 30, 2012 and 2011, the Company had no write-down on its exploration and evaluation assets.

Deferred tax assets:

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

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

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, 2012.

During the year ended June 30, 2012, the following options were granted:

| Date granted | Options granted | Exercise price | Expiry |
|---|---|---|---|
| October 11, 2011 | 2,180,000 | $ 0.40 | October 10, 2016 |
| February 8, 2012 | 225,000 | $ 0.56 | February 7, 2017 |
| | 2,405,000 | | |

The fair value of the options granted during the year ended June 30, 2012 was estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

| Black-Scholes option valuation model assumptions used (weighted average) | |
|---|---|
| Expected volatility (i) | 115.7% |
| Expected dividend yield | 0% |
| Risk-free interest rate | 1.3% |
| Expected option life in years | 3.6 years |
| Expected forfeiture rate | 6.8% |
| Fair value per stock option granted on October 11, 2011 | $ 0.29 |
| Fair value per stock option granted on February 8, 2012 | $ 0.41 |

(i) Based on the historical volatility of Brownstone's share price

Valuation of Unlisted Warrants of Public Companies:

The Company uses the Black-Scholes option pricing model to calculate the fair value of unlisted warrants of public companies if there are sufficient and reliable observable market inputs; if no such market inputs are available, the warrants are valued at intrinsic value. The model requires six key inputs: risk free interest rate, exercise price, market price at date of issue, expected dividend yield, expected life and expected volatility. The first four inputs are facts rather than estimates, while the expected life, expected volatility and expected dividend yield (estimated at 0% based on the Company's history of not paying any dividends) are based on the Company's estimates. A shorter expected life of the warrant, lower volatility number or higher dividend yield used would result in a decrease in the fair value of the warrant. A longer expected life of the warrant or a higher volatility number used would result in an increase in the fair value of the warrant. These estimates involve considerable judgment and are, or could be, affected by significant factors that are out of the Company's control. As at September 30, 2012 and June 30, 2012, there were not sufficient reliable observable market inputs and thus, the Company valued the warrants in its portfolio using their intrinsic value.

## Outstanding Share Data:

As at November 27, 2012, 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 | **8,925,080** |
| Issuable under warrants | **7,951,454** |
| **Total diluted common shares** | **146,670,823** |

Refer to note 5 of the notes to the consolidated financial statements as at and for the three months ended September 30, 2012 for details of the Company's share capital as at September 30, 2012.

Subsequent to September 30, 2012, the Company's board of directors approved the grant of 2,390,000 options to certain officers, directors, employees and consultants of the Company. Each option is exercisable into one common share of the Company for a period of five years, vesting quarterly for a period of 18 months, at a price equal to the closing price of the Company's common shares on the TSX Venture Exchange on November 28, 2012.

## 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.