

Interim Condensed Consolidated Financial Statements of

Brownstone Energy Inc.

December 31, 2013

(Unaudited - prepared in Canadian dollars)

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BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)**

Notice to reader pursuant to National Instrument 51-102 – Continuous Disclosure Obligations

Under National Instrument 51-102 – Continuous Disclosure Obligations, if an auditor has not performed a review of a reporting issuer's interim financial statements, the financial statements must be accompanied by a notice indicating that they have not been reviewed by an auditor.

The Company's independent auditor has not performed a review of these interim condensed consolidated financial statements in accordance with standards established by the Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditor.

BROWNSTONE ENERGY INC.
Consolidated Statements of Financial Position
As at December 31, 2013 and June 30, 2013
(Unaudited - prepared in Canadian dollars)

	<u>Notes</u>	<u>December 31,</u> <u>2013</u>	<u>June 30,</u> <u>2013</u>
Assets			
Current			
Cash and cash equivalents		\$ 6,944,760	\$ 9,595,064
Restricted cash - current	4(a)(ii)	589,235	-
Prepays and receivables		1,324,526	1,136,807
Investments, at fair value	5	2,015,188	1,667,208
Income taxes receivable		18,782	144,471
		<u>10,892,491</u>	<u>12,543,550</u>
Restricted cash		-	634,925
Exploration and evaluation assets	4	<u>15,256,312</u>	<u>17,274,483</u>
		<u>\$ 26,148,803</u>	<u>\$ 30,452,958</u>
Liabilities and Equity			
Current			
Accounts payable and accrued liabilities		\$ 1,581,476	\$ 3,478,478
Income taxes payable		-	72,642
		<u>1,581,476</u>	<u>3,551,120</u>
Equity			
Share capital	6(a)	96,597,845	96,597,845
Contributed surplus	6(c)	21,919,772	21,806,275
Warrants	6(d)	2,559,317	2,559,317
Foreign currency translation reserve		86,026	(79,081)
Deficit		<u>(96,595,633)</u>	<u>(93,982,518)</u>
		<u>24,567,327</u>	<u>26,901,838</u>
		<u>\$ 26,148,803</u>	<u>\$ 30,452,958</u>

See accompanying notes to the interim condensed consolidated financial statements.

BROWNSTONE ENERGY INC.**Consolidated Statements of Comprehensive Loss**
Three And Six Months Ended December 31,
(Unaudited - prepared in Canadian dollars)

		<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>Notes</u>	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Net change in unrealized gains (losses) on investments		\$ (81,206)	\$ (674,534)	\$ 347,980	\$ (962,000)
Interest and other income		26,527	50,043	30,533	98,501
		(54,679)	(624,491)	378,513	(863,499)
Expenses					
Operating, general and administrative	6(b), 8	507,560	725,175	1,347,806	1,445,934
Impairment of exploration and evaluation assets	4(a)(i), e)	1,372,310	4,586,574	1,459,366	4,586,574
		1,879,870	5,311,749	2,807,172	6,032,508
Loss before income taxes		(1,934,549)	(5,936,240)	(2,428,659)	(6,896,007)
Income tax expense		160,642	104,469	184,456	240,393
Net loss for the period		\$ (2,095,191)	\$ (6,040,709)	(2,613,115)	(7,136,400)
Other comprehensive income (loss)					
Exchange differences on translation of foreign operations		491,092	551,725	165,107	(1,089,767)
Total comprehensive loss for the period		\$ (1,604,099)	\$ (5,488,984)	\$ (2,448,008)	\$ (8,226,167)
Loss per common share based on net loss for the period	6(e)				
Basic and diluted		\$ (0.02)	\$ (0.05)	\$ (0.02)	\$ (0.05)
Weighted average number of common shares outstanding	6(e)				
Basic and diluted		129,794,289	129,794,289	129,794,289	129,794,289

See accompanying notes to the interim condensed consolidated financial statements.

BROWNSTONE ENERGY INC.**Consolidated Statements of Changes in Equity**
Six Months Ended December 31, 2013 and 2012
(Unaudited - prepared in Canadian dollars)

		Number of shares	Share capital	Warrants and broker warrants	Contributed surplus	Foreign currency translation reserve	Deficit	Total equity
Balance at June 30, 2012	Notes	129,794,289	\$ 96,597,845	\$ 7,310,433	\$ 16,642,202	\$ (928,739)	\$ (53,122,337)	\$ 66,499,404
Net loss for the period		-	-	-	-	-	(7,136,400)	(7,136,400)
Exchange differences on translation of foreign operations		-	-	-	-	(1,089,767)	-	(1,089,767)
Total comprehensive loss for the period		-	-	-	-	(1,089,767)	(7,136,400)	(8,226,167)
Stock-based compensation expense	6(b)	-	-	-	225,114	-	-	225,114
Reallocation of expired warrants	6(d)	-	-	(4,751,116)	4,751,116	-	-	-
Balance at December 31, 2012		<u>129,794,289</u>	<u>\$ 96,597,845</u>	<u>\$ 2,559,317</u>	<u>\$ 21,618,432</u>	<u>\$ (2,018,506)</u>	<u>\$ (60,258,737)</u>	<u>\$ 58,498,351</u>
Balance at June 30, 2013		<u>129,794,289</u>	<u>\$ 96,597,845</u>	<u>\$ 2,559,317</u>	<u>\$ 21,806,275</u>	<u>\$ (79,081)</u>	<u>\$ (93,982,518)</u>	<u>\$ 26,901,838</u>
Net loss for the period		-	-	-	-	-	(2,613,115)	(2,613,115)
Exchange differences on translation of foreign operations		-	-	-	-	165,107	-	165,107
Total comprehensive loss for the period		-	-	-	-	165,107	(2,613,115)	(2,448,008)
Stock-based compensation expense	6(b)	-	-	-	113,497	-	-	113,497
Balance at December 31, 2013		<u>129,794,289</u>	<u>\$ 96,597,845</u>	<u>\$ 2,559,317</u>	<u>\$ 21,919,772</u>	<u>\$ 86,026</u>	<u>\$ (96,595,633)</u>	<u>\$ 24,567,327</u>

See accompanying notes to the interim condensed consolidated financial statements.

BROWNSTONE ENERGY INC.
Consolidated Statements of Cash Flows
Six Months Ended December 31,
(Unaudited - prepared in Canadian dollars)

	<u>Notes</u>	<u>2013</u>	<u>2012</u>
Cash flows used in operating activities			
Net loss for the period		\$ (2,613,115)	\$ (7,136,400)
Items not affecting cash			
Net change in unrealized losses (gains) on investments		(347,980)	962,000
Impairment of exploration and evaluation assets	4(a)(i), e)	1,459,366	4,586,574
Stock-based compensation expense	6(b)	113,497	225,114
		<u>(1,388,232)</u>	<u>(1,362,712)</u>
Changes in non-cash working capital balances			
Prepays and receivables		(187,719)	(439,853)
Income taxes receivable		125,689	-
Accounts payable and accrued liabilities		89,548	174,863
Income taxes payable		(72,642)	79,102
		<u>(1,433,356)</u>	<u>(1,548,600)</u>
Cash flows used in investing activities			
Expenditures on exploration and evaluation assets, net	4	(1,302,019)	(5,865,255)
Proceeds on sale of exploration and evaluation assets	4(c)	58,980	12,704
Repayment of promissory note receivable		-	(36,339)
Decrease in restricted cash		45,690	-
Purchases of investments		-	(500,000)
		<u>(1,197,349)</u>	<u>(6,388,890)</u>
Net decrease in cash and cash equivalents during the period		(2,630,705)	(7,937,490)
Exchange rate changes on foreign currency cash balances		(19,599)	(66,733)
Cash and cash equivalents, beginning of period		9,595,064	18,197,006
Cash and cash equivalents, end of period		\$ 6,944,760	\$ 10,192,783
Supplemental cash flow information			
Income taxes paid		\$ 203,238	\$ 161,291
Finance expense paid		-	-

See accompanying notes to the interim condensed consolidated financial statements.

BROWNSTONE ENERGY INC.

Notes to the Interim Condensed Consolidated Financial Statements

December 31, 2013

(Unaudited - prepared in Canadian dollars)

1. Nature of business and going concern uncertainty:

Brownstone Energy Inc. ("Brownstone" or the "Company") was continued under the Canada Business Corporations Act on December 1, 2011 and its common shares are publicly-traded on the TSX Venture Exchange under the symbol "BWN" and on the OTCQX under the symbol "BWSOF". The Company is domiciled in the Province of Ontario and its head office is located at 130 King St. West, Suite 2500, Toronto, Ontario, Canada.

Brownstone is a Canadian-based, energy-focused company with direct interests in oil and gas exploration projects in several countries, including offshore Israel.

These interim condensed consolidated financial statements ("interim consolidated statements") were approved for issuance by the Company's board of directors on February 27, 2014.

These interim consolidated statements have been prepared using accounting policies applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they become due. The Company has incurred a loss in the six months ended December 31, 2013 of \$2,613,115 (six months ended December 31, 2012 - \$7,136,400) and has an accumulated deficit of \$96,595,633 (June 30, 2013 - \$93,982,518). The Company is in the exploration stage and is subject to risks and challenges similar to other companies in a comparable stage of exploration. These risks include, but are not limited to, dependence on key individuals, successful exploration and the ability to secure adequate financing to meet the minimum capital required to successfully complete the projects, political risk relating to maintaining property licenses in good standing and continuing as a going concern. Management estimates that the funds available as at December 31, 2013 will not be sufficient to meet the Company's potential capital expenditures through December 31, 2014. The Company will have to raise additional funds to continue operations. Although the Company has been successful in raising funds to date, there can be no assurance that adequate funding will be available in the future, or available on terms acceptable to the Company. Failure to meet its funding commitments with its partners may result in the loss of the Company's exploration and evaluation interests.

The challenges of securing requisite funding beyond December 31, 2013 and the continued estimated operating losses cast significant doubt on the Company's ability to continue as a going concern. The consolidated statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts nor to the amounts or classification of liabilities that might be necessary should the Company not be able to continue as a going concern.

2. Basis of preparation:

(a) Statement of compliance:

These interim consolidated statements are unaudited and have been prepared on a condensed basis in accordance with International Accounting Standard 34, *Interim Financial Reporting*, issued by the International Accounting Standards Board and interpretations of the International Financial Reporting Interpretations Committee using accounting policies consistent with International Financial Reporting Standards ("IFRS").

BROWNSTONE ENERGY INC.

Notes to the Interim Condensed Consolidated Financial Statements

December 31, 2013

(Unaudited - prepared in Canadian dollars)

2. Basis of preparation (continued):

Except as described in note 3, the same accounting policies and methods of computation were followed in the preparation of these interim consolidated statements as were followed in the preparation of and as described in note 3 of the annual consolidated financial statements as at and for the year ended June 30, 2013. Accordingly, these interim consolidated statements for the three and six months ended December 31, 2013 and 2012 should be read together with the annual consolidated financial statements as at and for the year ended June 30, 2013.

(b) Basis of presentation:

These interim consolidated statements have been prepared using the historical cost convention except for certain financial instruments which have been measured at fair value. All monetary references expressed in these notes are references to Canadian dollar amounts ("\$/").

(c) Basis of consolidation:

These interim consolidated statements include the financial statements of Brownstone and its wholly-owned subsidiaries: Brownstone Ventures (US) Inc., Brownstone Ventures (Barbados) Inc., Brownstone Comercializadora de Petroleo Ltda., and 2121197 Ontario Ltd.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. All inter-company account balances and transactions have been eliminated upon consolidation.

3. Changes in accounting polices:

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

(a) IFRS 7, *Financial Instruments, Disclosures*, amended to provide more extensive quantitative disclosures for financial instruments that are offset in the consolidated statement of financial position or that are subject to enforceable master netting similar arrangements. The Company has assessed and determined that the amendments to IFRS 7 did not result in any change in its disclosures for financial instruments.

(b) IFRS 10, *Consolidated Financial Statements*, requires consolidation of an investee only if the investor possesses power over the investee, has exposure to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect its returns. Detailed guidance is provided on applying the definition of control. The Company has assessed its consolidation conclusions on July 1, 2013 and determined that the adoption of IFRS 10 did not result in any change in the consolidation status of any of its subsidiaries and investees.

BROWNSTONE ENERGY INC.

Notes to the Interim Condensed Consolidated Financial Statements

December 31, 2013

(Unaudited - prepared in Canadian dollars)

3. Changes in accounting policies (continued):

- (c) IFRS 11, *Joint Arrangements*, supersedes IAS 31, *Interests in Joint Ventures*, and requires joint arrangements to be classified either as joint operations or joint ventures depending on the contractual rights and obligations of each investor that jointly controls the arrangement. For joint operations, a company recognizes its share of assets, liabilities, revenues and expenses of the joint operation. An investment in a joint venture is accounted for using the equity method as set out in IAS 28, *Investments in Associates and Joint Ventures* (amended in 2011). The other amendments to IAS 28 did not affect the Company. The Company has concluded that the adoption of IFRS 11 did not result in any changes in the accounting.
- (d) IFRS 12, *Disclosure of Interests in Other Entities*, requires the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with an entity's interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. The Company does not have any material subsidiaries outside of those disclosed in note 2(c) that requires additional disclosures. The Company does not have any associates that are individually material nor any associates that are accounted for using the equity method that requires additional disclosures. The Company does not have interests in joint arrangements or interest in unconsolidated structured entities. The Company has assessed and determined that the adoption of IFRS 12 did not result in any significant change in its disclosures of interests in other entities.
- (e) IFRS 13, *Fair Value Measurement*, provides the guidance on the measurement of fair value and related disclosures through a fair value hierarchy. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. As a result of the guidance in IFRS 13, the Company re-assessed its policies for measuring fair value.

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

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

IFRS 13 also requires additional disclosures. Additional disclosures where required are provided in the individual notes relating to the assets and liabilities whose fair values were determined. Fair value hierarchy is provided in Note 5(b).

BROWNSTONE ENERGY INC.

Notes to the Interim Condensed Consolidated Financial Statements

December 31, 2013

(Unaudited - prepared in Canadian dollars)

3. Changes in accounting policies (continued):

- (f) IAS 19R, *Employee Benefits*, includes a number of amendments to the accounting for defined benefit plans, including actuarial gains and losses that are now recognised in other comprehensive income and permanently excluded from profit and loss; expected returns on plan assets that are no longer recognised in profit or loss, instead, there is a requirement to recognise interest on the net defined benefit liability (asset) in profit or loss, calculated using the discount rate used to measure the defined benefit obligation; and unvested past service costs are now recognised in profit or loss at the earlier of when the amendment occurs or when the rated restructuring or termination costs are recognised. Other amendments include new disclosures, such as, quantitative sensitivity disclosures. The Company has assessed its employee benefits, including unused vacation accrual, and determined that the amendments to IAS 19R did not have any significant impact on the consolidated financial statements.
- (g) IAS 27, *Separate Financial Statements*, as a result of the issue of the new consolidation suite of standards, IAS 27 has been reissued, as the consolidation guidance will now be included in IFRS 10. IAS 27 will now only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The Company does not prepare separate financial statements, therefore, IAS 27 does not impact the Company.
- (h) IAS 28, *Investments in Associates and Joint Ventures*, as a consequence of the issue of IFRS 10, IFRS 11 and IFRS 12 has been amended and will provide the accounting guidance for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. The amended IAS 28 will be applied by all entities that are investors with joint control of, or significant influence over, an investee. None of these disclosures requirements are applicable for interim condensed consolidated financial statements, unless significant events and transactions in the interim periods require that they be provided. Accordingly, the Company has not made such disclosures.
- (i) IAS 32, *Financial Instruments, Presentation* was amended to clarify the requirements for offsetting financial assets and liabilities. The amendments clarify that the right of offset must be available on the current date and cannot be contingent on a future date. The Company has early adopted IAS 32 effective on July 1, 2013 and determined that there was no significant impact on the consolidated financial statements.

4. 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 and maintain 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.

BROWNSTONE ENERGY INC.

Notes to the Interim Condensed Consolidated Financial Statements

December 31, 2013

(Unaudited - prepared in Canadian dollars)

4. Exploration and evaluation assets (continued):

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

	Colombia (a)	Israel (b)	USA (c)	Canada (d)	Argentina (e)	Total
	\$	\$	\$	\$	\$	\$
Balance at July 1, 2012	34,745,055	4,614,117	3,646,119	1,116,757	1,019,100	45,141,148
Net additions ¹ :	6,255,290	6,067,145	1,148,394	13,711	111,334	13,595,874
Disposals	(6,140,400)	-	-	-	-	(6,140,400)
Impairment of exploration and evaluation assets	(34,313,636)	(1,380,604)	(588,818)	-	(111,334)	(36,394,392)
Foreign currency translation	504,891	364,260	171,002	-	32,100	1,072,253
Balance at June 30, 2013	1,051,200	9,664,918	4,376,697	1,130,468	1,051,200	17,274,483
Net additions ¹ :	306,317	(826,566)	(64,015)	12,689	(112,956)	(684,531)
Disposals	-	-	(58,980)	-	-	(58,980)
Impairment of exploration and evaluation assets	(1,372,310)	-	-	-	(87,056)	(1,459,366)
Foreign currency translation	14,793	114,007	50,332	-	5,574	184,706
Balance at December 31, 2013	-	8,952,359	4,304,034	1,143,157	856,762	15,256,312

¹: Net additions reflects expenditures on exploration and evaluation assets less revenue received from sales of oil generated during long-term production testing (if any).

(a) Colombia:

For the six months ended December 31, 2013, included in net additions was \$1,489,106 (six months ended December 31, 2012 - \$4,688,291) of revenue from sales of oil generated from long-term production testing on Block 27 in the Llanos Basin of Central Colombia. During the year ended June 30, 2013, the Company spent \$6,255,290 on exploration and evaluation of the blocks in Colombia, net of \$7,917,608 oil sales revenue generated from long-term production testing (Block 27(i) and Canaguaro Block). The Canaguaro Block was sold in June 2013 for total gross proceeds of US\$6,000,000. Included in the statement of cash flows is the cash spent on expenditures and evaluation, net of oil sales from long-term production testing.

A summary of the Company's private participating interests in the Colombian blocks as at December 31, 2013 is as follows:

Block 27 (i)	
Private participation interest	34.25%
Increased costs assumed	50%
Increased participation interest	45.275%

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

BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)**

4. Exploration and evaluation assets (continued):

During the six months ended December 31, 2013, the Company recorded an impairment charge of \$1,372,310. The impairment was recognized upon a review by management to its estimated recoverable amount of nil. The Company does not believe its private participating interest can be sold for any value. See note 11(a).

- (ii) Block 36: In October 2013, the Company assigned its 14% private participating interest in Block 36 to the operator of the Block for no consideration. As at December 31, 2013, the Company had no further obligations or liabilities in respect of the Block, except (a) in connection with a US\$1,100,000 letter of guarantee previously provided to the Agencia Nacional de Hidrocarburos ("ANH"), a Colombian government oil and gas agency, by the Company's bank on its behalf, of which US\$554,000 was secured by the Company and held in (current) restricted cash and US\$546,000 was guaranteed by a performance security guarantee issued by Export Development Canada ("EDC"), a Canadian federal government agency, for which the Company had indemnified EDC, and (b) approximately US\$146,500 payable in respect to historical cash calls. See note 11(b).

(b) Israel:

As at December 31, 2013, the Company has the following participating interests in Israel and is required to fund its share of the participating interests:

	Gabriella Block	Yitzhak Block
Participating Interest	15%	15%

In October 2013, the Operator of the Gabriella and Yitzhak licenses received extensions for certain milestone dates and the expiry dates of the licenses. The new expiry dates of the Gabriella and Yitzhak licenses are September 1, 2014 and October 15, 2014, respectively. During the six months ended December 31, 2013, the Company reverse some of the cash calls which were accrued as at June 30, 2013.

Additionally, in October 2013, Brownstone and the other holders of the Samuel license (in respect of which Brownstone had a 6.75% participating interest) relinquished their interests in the license back to the State of Israel.

(c) USA:

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

During the six months ended December 31, 2013, the Company sold some of its USA interests for total proceeds of \$58,980 (US\$55,840) and received \$91,554 (US\$87,899) in net oil sales revenue from long-term production testing.

BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)**

4. Exploration and evaluation assets (continued):

(d) Canada:

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

During six months ended December 31, 2013, the Company spent \$12,689 (year ended June 30, 2012 - \$13,711) to maintain the properties in good standing and management believes there is no impairment.

(e) Argentina:

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

During the six months ended December 31, 2013, the Company reversed accruals of \$112,956 that were recorded as at June 30, 2013 and recorded an impairment charge of \$87,056. The impairment was recognized upon a review of the Company's interest in the Block and its estimated recoverable amount of US\$805,530. The recoverable amount was determined based on the amount for which the Company has agreed to relinquish its 25% working interest to Petrolifera Petroleum (Americas) Limited Sucursal Argentina ("PPAL"), the operator of the Block subject to certain conditions including the approval by the Province of Rio Negro of the Exploitation Concession on the Area (the Vaca Mahuida Block). There is no certainty that the Exploitation Concession for the Block will be approved by the Province of Rio Negro.

5. Investments at fair value and financial instruments hierarchy:

(a) The fair value and cost of investments are as follows:

	Fair Value	Cost
December 31, 2013	\$ 2,015,188	\$ 13,750,659
June 30, 2013	1,667,208	13,750,659

BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)**

5. Investments at fair value and financial instruments hierarchy (continued):

(b) Financial instruments hierarchy:

The following table presents the Company's financial instruments, measured at fair value and categorized into levels of the fair value hierarchy on the consolidated statements of financial position as at December 31, 2013 and June 30, 2013:

	Level 1	Level 2	Level 3	
	Quoted	Valuation technique	Valuation technique	Total
Investments, at fair value	market price	– observable	– non-observable	
		market inputs	market inputs	
December 31, 2013	\$ 1,265,188	\$ -	\$ 750,000	\$ 2,018,188
June 30, 2013	917,208	-	750,000	1,667,208

There were no significant transfers from Level 1 to 2 or Level 2 to 1 during the six months ended December 31, 2013 or for the year ended June 30, 2013.

The following table presents the changes in fair value measurements of financial instruments classified as Level 3. These financial instruments are measured at fair value utilizing non-observable market inputs. The net change in unrealized losses are recognized in the consolidated statements of comprehensive loss.

	Opening		Net unrealized	Net transfer	Ending
	balance at	Purchases	losses	out of	balance
	July 1,			Level 3	
December 31, 2013	\$ 750,000	\$ -	\$ -	\$ -	\$ 750,000
June 30, 2013	\$ 1,025,000	\$ -	\$ (275,000)	\$ -	\$ 750,000

6. Equity:

(a) Authorized: unlimited number of common shares (no par value).

(b) Stock options:

During the six months ended December 31, 2013, the Company granted 2,980,000 stock options exercisable at \$0.10 per share expiring on September 9, 2018.

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

BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)**

6. Equity (continued):

The fair value of the options granted during the six months ended December 31, 2013 was estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

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

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

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

The expected volatility is based on the historical volatility over the life of the option at Brownstone's share price. The Company has not paid any cash dividends historically and has no plans to pay cash dividends in the foreseeable future. The risk-free interest rate is based on the yield of Canadian Benchmark Bonds with equivalent terms. The expected option life in years represents the period of time that options granted are expected to be outstanding based on historical options granted.

For the three months ended December 31, 2013, included in operating, general and administrative expenses was stock-based compensation expense of \$64,222 (three months ended December 31, 2012 - \$97,142) relating to the stock options granted to directors, officers, employees and consultants of the Company.

For the six months ended December 31, 2013, included in operating, general and administrative expenses was stock-based compensation expense of \$113,497 (six months ended December 31, 2012 - \$225,114) relating to the stock options granted to directors, officers, employees and consultants of the Company.

BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)****6. Equity (continued):**

A summary of the status of the Company's stock options as at December 31, 2013 and June 30, 2013 and changes during the periods then ended is presented below:

Stock options	December 31, 2013		June 30, 2013	
	# of options	Weighted average exercise price	# of options	Weighted average exercise price
Outstanding, at beginning of period	9,975,080	\$ 0.52	8,925,080	\$ 0.72
Granted	2,980,000	0.10	2,390,000	0.17
Forfeited	(16,668)	0.17	(8,334)	0.40
Expired	(178,332)	0.53	(1,331,666)	1.25
Outstanding, at end of period	12,760,080	\$ 0.42	9,975,080	\$ 0.52
Exercisable, at end of period	9,488,392	\$ 0.53	8,344,232	\$ 0.59

The following table summarizes information about stock options outstanding and exercisable as at December 31, 2013:

Number of options outstanding	Number of options exercisable	Exercise price	Expiry date
1,128,400	1,128,400	\$ 0.52	August 12, 2014
10,000	10,000	0.61	October 5, 2014
50,000	50,000	0.75	November 26, 2014
200,000	200,000	0.75	November 30, 2014
500,000	500,000	0.65	March 2, 2015
630,000	630,000	0.65	April 14, 2015
130,000	130,000	0.43	May 25, 2015
1,111,680	1,111,680	0.51	September 20, 2015
1,325,000	1,325,000	1.20	March 29, 2016
2,105,000	2,105,000	0.40	October 10, 2016
225,000	225,000	0.56	February 7, 2017
2,365,000	1,576,652	0.17	November 28, 2017
2,980,000	496,660	0.10	September 9, 2018
12,760,080	9,488,392		

(c) Contributed surplus comprised the following as at December 31, 2013 and June 30, 2013:

	December 31, 2013	June 30, 2013
Stock-based compensation	\$ 10,036,505	\$ 9,923,008
Expired warrants and broker warrants	11,857,003	11,857,003
Cancellation of common shares under normal course issuer bid	20,639	20,639
Value of cancelled escrowed shares	5,625	5,625
	\$ 21,919,772	\$ 21,806,275

BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)****6. Equity (continued):**

- (d) A summary of the status of the Company's warrants and broker warrants at the reporting dates and the changes during the periods then ended are as follows:

	December 31, 2013		
	# of warrants	Weighted average exercise price	Amount
Outstanding, at beginning of period	7,951,454	\$ 0.75	\$ 2,559,317
Expired	-	-	-
Outstanding, at end of period	7,951,454	\$ 0.75	\$ 2,559,317

	June 30, 2013		
	# of warrants and broker warrants	Weighted average exercise price	Amount
Outstanding, at beginning of year	25,201,454	\$ 1.09	\$ 7,310,433
Expired	(17,250,000)	1.25	(4,751,116)
Outstanding, at end of year	7,951,454	\$ 0.75	\$ 2,559,317

The following table summarizes information about warrants outstanding as at December 31, 2013:

Number of warrants and broker warrants	Exercise price	Expiry date	Warrants and broker warrants value
7,951,454	\$ 0.75	April 13, 2014	\$ 2,559,317
7,951,454			\$ 2,559,317

- (e) Basic and diluted loss per common share based on loss for the three and six months ended December 31:

Numerator:	Three months ended December 31,		Six months ended December 31,	
	2013	2012	2013	2012
Net loss for the period	\$ (2,095,191)	\$ (6,040,709)	\$ (2,613,115)	\$ (7,136,400)

Denominator:	Three months ended December 31,		Six months ended December 31,	
	2013	2012	2013	2012
Weighted average number of common shares outstanding - basic	129,794,289	129,794,289	129,794,289	129,794,289
Weighted average effect of diluted stock options and warrants (i)	-	-	-	-
Weighted average number of common shares outstanding - diluted	129,794,289	129,794,289	129,794,289	129,794,289

BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)**

6. Equity (continued):

Loss per common share based on net loss for the period:	Three months ended December 31,		Six months ended December 31,	
	2013	2012	2013	2012
Basic and diluted	\$ (0.02)	\$ (0.05)	\$ (0.02)	\$ (0.05)

(i) The determination of the weighted average number of common shares outstanding – diluted excludes 20,711,534 shares related to stock options and warrants that were anti-dilutive for the period ended December 31, 2013 (periods ended December 31, 2012 – 19,266,534 shares).

(f) Maximum share dilution:

The following table presents the maximum number of shares that would be outstanding if all outstanding stock options, warrants and broker warrants were exercised as at December 31, 2013 and June 30, 2013:

	December 31, 2013	June 30, 2013
Common shares outstanding	129,794,289	129,794,289
Stock options to purchase common shares	12,760,080	9,975,080
Warrants to purchase common shares	7,951,454	7,951,454
Fully diluted common shares outstanding	150,505,823	147,720,823

7. Segmented information:

Reportable segments are defined as components of an enterprise about which separate financial information is available, that are 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 consist of six distinct geographic areas: Colombia, Israel, Canada, United States, Argentina and Brazil. There were no changes in the reportable segments since June 30, 2013.

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

BROWNSTONE ENERGY INC.

Notes to the Interim Condensed Consolidated Financial Statements

December 31, 2013

(Unaudited - prepared in Canadian dollars)

7. Segmented information (continued):

The following is segmented information as at and for the six months ended December 31, 2013:

	Six months ended December 31, 2013		As at December 31, 2013		
	Interest and other income	Loss for the period	Exploration and evaluation assets	Other assets	Total assets
Canada and other	\$ 1,824	\$ 649,285	\$ 1,143,157	\$ 9,909,737	\$ 11,052,894
Israel	1,478	27,706	8,952,359	28,729	8,981,088
United States	-	-	4,304,034	32,245	4,336,279
Colombia	27,231	1,818,357	-	794,431	794,431
Argentina	-	117,767	856,762	691	857,453
Brazil	-	-	-	126,658	126,658
	\$ 30,533	\$ 2,613,115	\$ 15,256,312	\$ 10,892,491	\$ 26,148,803

The following is segmented information for the six months ended December 31, 2012 and as at June 30, 2013:

	Six months ended December 31, 2012		As at June 30, 2013		
	Interest and other income	Loss for the period	Exploration and evaluation assets	Other assets	Total assets
Canada and other	\$ 61,112	\$ (2,278,765)	\$ 1,130,468	\$ 11,443,473	\$ 12,573,941
Israel	-	(30,327)	9,664,918	78,918	9,743,836
United States	12,704	12,651	4,376,697	18,814	4,395,511
Colombia	24,685	(4,839,959)	1,051,200	1,488,705	2,539,905
Argentina	-	-	1,051,200	14,622	1,065,822
Brazil	-	-	-	133,943	133,943
	\$ 98,501	\$ (7,136,400)	\$ 17,274,483	\$ 13,178,475	\$ 30,452,958

8. Expenses by nature:

Included in operating, general, and administrative expenses for the three and six months ended December 31 are the following expenses:

	Three months ended December 31,		Six months ended December 31,	
	2013	2012	2013	2012
Salaries and consulting fees	\$ 375,664	\$ 391,948	\$ 808,619	\$ 752,523
Exploration expenses	152,877	-	152,877	-
Other office and general	58,223	33,375	124,613	231,927
Stock-based compensation expense	64,222	97,142	113,497	225,114
Professional fees	43,928	46,831	98,524	98,541
Shareholder relations, transfer agent and filing fees	61,839	58,125	66,455	69,558
Travel and promotion	9,964	86,954	26,038	102,270
Other employment benefits	5,499	5,839	12,035	12,584
Foreign exchange loss (gain)	(264,656)	4,961	(54,852)	(46,583)
	\$ 507,560	\$ 725,175	\$ 1,347,806	\$ 1,445,934

BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)**

9. Management of capital:

There were no changes in the Company's approach to capital management during the six months ended December 31, 2013. The Company's capital includes equity comprised of share capital, 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 December 31, 2013.

10. Risk management:

The investment operations of Brownstone's business involve the purchase and sale of securities and, accordingly, a 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:

There were no changes in the way the Company manages market risk during the six months ended December 31, 2013. The Company manages market risk by having a portfolio which is not singularly exposed to any one issuer; however, its investment activities are currently concentrated primarily in the oil and gas resource industry.

The following table shows the estimated sensitivity of the Company's after-tax net loss for the three and six months ended December 31, 2013 from a change in the closing trade price of the Company's investments with all other variables held constant as at December 31, 2013:

Percentage of change in closing bid price	Decrease in net after-tax loss from % increase in closing bid price	Increase in net after-tax loss from % decrease in closing bid price
2%	\$ 34,964	\$ (34,964)
4%	69,927	(69,927)
6%	104,891	(104,891)
8%	139,854	(139,854)
10%	174,818	(179,818)

BROWNSTONE ENERGY INC.

Notes to the Interim Condensed Consolidated Financial Statements

December 31, 2013

(Unaudited - prepared in Canadian dollars)

10. Risk management (continued):

The following table shows the estimated sensitivity of the Company's after-tax net loss for the three and six months ended December 31, 2012 from a change in the closing bid price of the Company's investments with all other variables held constant as at December 31, 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%	\$ 40,069	\$ (40,069)
4%	80,139	(80,139)
6%	120,208	(120,208)
8%	160,277	(160,277)
10%	200,346	(200,346)

(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:

	December 31, 2013	June 30, 2013
Denominated in U.S. dollars:		
Cash and cash equivalents	\$ 6,444,454	\$ 8,014,927
Restricted cash	589,234	634,925
Prepays and receivables	644,302	1,089,282
Income tax receivable	18,782	144,471
Exploration and evaluation assets	14,113,155	16,144,015
Accounts payable and accrued liabilities	(2,390,144)	(3,338,441)
Net assets denominated in U.S. dollars	19,419,783	22,689,179
Denominated in Brazilian reals:		
Cash and cash equivalents	126,658	133,943
Net assets denominated in Brazilian reals	126,658	133,943
Denominated in Argentinean pesos:		
Cash and cash equivalents	691	14,622
Accounts payable and accrued liabilities	-	(53,469)
Income taxes payable	-	(72,642)
Net assets denominated in Argentinean pesos	691	(111,489)
Denominated in Colombian pesos:		
Cash and cash equivalents	143,273	282,773
Net assets denominated in Colombian pesos	143,273	282,773

BROWNSTONE ENERGY INC.**Notes to the Interim Condensed Consolidated Financial Statements****December 31, 2013****(Unaudited - prepared in Canadian dollars)**

10. Risk management (continued):

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the three and six months ended December 31, 2013 from a change in the U.S. dollar exchange rate in which the Company has significant exposure with all other variables held constant as at December 31, 2013:

Percentage change in U.S. dollar exchange rate	Decrease in total comprehensive loss from an increase in % in the U.S. dollar exchange rate	Increase in total comprehensive loss from a decrease in % in the U.S. dollar exchange rate
2%	\$ 285,471	\$ (285,471)
4%	570,942	(570,942)
6%	856,412	(856,412)
8%	1,141,883	(1,141,883)
10%	1,427,354	(1,427,354)

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

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

11. Subsequent note:

- (a) Subsequent to December 31, 2013, the Company assigned its 34.25% private participating interest in the rights and obligations of Block 27 in Colombia to Santa Maria Petroleum Inc. Sucursal Colombia, the operator of the Block, for nil proceeds. As a result, the US\$1,850,000 letter of guarantee in respect of the Phase 2 work commitments for Block 27 that was issued by the Company's bank to the ANH was released by the ANH.
- (b) Subsequent to December 31, 2013, the letter of guarantee of US\$1,100,000 for Block 36 in Colombia was released by the ANH and payment of the outstanding cash calls was made (note 4(a(ii))).