AZABACHE Energy Inc.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

AS AT AND FOR THE THREE MONTHS AND SIX MONTHS ENDED DECEMBER 31, 2014 (unaudited)

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited condensed consolidated interim financial statements for the three month and six month periods ended December 31, 2014 and 2013

Azabache Energy Inc.

Condensed Consolidated Interim Statements of Financial Position

(in Canadian dollars)
(unaudited)

	December 31, 2014	June 30, 2014
Assets		
Current		
Cash and cash equivalents	$ 399,481	$ 681,334
Accounts receivable	299,487	159,766
Prepaid expenses and deposits	257,836	134,226
	956,804	975,326
Restricted cash (Note 3)	2,158,032	3,250,303
Exploration and evaluation assets (Note 4)	20,831,861	16,878,312
Property and equipment (Note 5)	148,400	164,600
	$ 24,095,097	$ 21,268,541
Liabilities		
Current		
Accounts payable and accrued liabilities	$ 1,497,271	$ 1,635,238
Loan payable (Note 6)	4,753,631	-
	6,250,902	1,635,238
Decommissioning provisions (Note 7)	1,571,429	1,402,202
	7,822,331	3,037,440
Shareholders' Equity		
Share capital (Note 8)	80,215,263	80,215,263
Contributed surplus	5,670,998	5,312,067
Accumulated other comprehensive loss	(5,356,513)	(5,726,807)
Deficit	(64,256,982)	(61,569,422)
	16,272,766	18,231,101
	$ 24,095,097	$ 21,268,541

On behalf of the Board

"Glenn Van Doorne" Director

"Claudio Larotonda" Director

The accompanying notes are an integral part of these condensed consolidated interim financial statements

Azabache Energy Inc.

Condensed Consolidated Interim Statements of Operations and Comprehensive Loss

(in Canadian dollars)
(unaudited)

	Three Months ended December 31		Six Months ended December 31	
	2014	2013	**2014**	2013
Expenses				
Management and consulting fees (note 17)	$ 220,656	$ 300,341	$ 362,388	$ 424,452
Salaries (Note 17)	317,001	444,309	677,487	874,087
Stock-based compensation (Notes 10 and 17)	166,816	211,103	358,931	424,853
Travel	92,820	93,381	193,479	167,010
General and administration (Note 12)	140,059	273,465	544,092	500,846
Shareholder information	19,697	13,025	23,713	17,349
Professional fees	(41,227)	108,223	167,389	172,928
Finance charges (Note 13)	165,899	52,452	305,255	98,301
Depreciation	(23,028)	-	(47,212)	-
Foreign exchange loss (gain)	3,566	18,283	17,347	43,164
Impairment of exploration and evaluation assets (Note 5)	59,987	39,894	84,691	(376,887)
Loss for the period	1,122,246	1,554,476	2,687,560	2,346,103
Exchange difference on translation of foreign operations	(95,167)	395,376	(370,294)	1,425,849
Total comprehensive loss for the period	$ 1,027,079	$ 1,949,852	$ 2,317,266	$ 3,771,952
Loss per share (basic and diluted)	$ 0.01	$ 0.01	$ 0.02	$ 0.02
Weighted average number of shares				
Basic and diluted	177,276,964	147,305,311	177,276,964	146,173,874

The accompanying notes are an integral part of these condensed consolidated interim financial statements

Azabache Energy Inc.

Condensed Consolidated Interim Statements of Cash Flows

(in Canadian dollars)
(unaudited)

	Three months ended December 31		Six Months Ended December 31	
	2014	2013	**2014**	2013
Cash provided by (used in):				
Operations				
Net loss for the period	$ (1,122,246)	$ (1,554,476)	$ (2,687,560)	$ (2,346,103)
Items not affecting cash:				
Stock-based compensation (Note 10)	166,816	211,103	358,931	424,853
Impairment of exploration and evaluation assets (Note 5)	-	-	-	-
Depreciation	3,566	18,283	17,347	43,164
Accretion of loan liability (Note 7)	-	12,163	-	30,407
Accretion of decommissioning liability (Note 8)	75,688	44,369	149,795	91,964
Foreign exchange loss (gain)	(102,654)	628,199	177,015	1,039,151
Net change in non-cash working capital items:				
Accounts receivable	(134,771)	(75,289)	(139,721)	(85,813)
Prepaid expenses and deposits	(83,633)	(102,222)	(123,610)	(69,480)
Accounts payable and accrued liabilities	(222,595)	212,610	(42,832)	134,825
Cash flows used in operating activities	(1,419,829)	(605,260)	(2,290,635)	(737,032)
Investing				
Additions to exploration and evaluation assets	(873,316)	(359,330)	(1,354,902)	(653,831)
Proceeds from exploration and evaluation assets (Note 5)	-	532,206	-	532,206
Decrease in payables related to investment activities	717,059	(140,134)	(95,136)	(375,754)
Additions to property and equipment	-	(1,689)	(3,901)	(1,689)
Decrease in exploration advances	-	-	-	-
Decrease in restricted cash	893,857	146,351	1,092,273	272,512
Cash flows used in investing activities	737,600	177,404	(361,666)	(226,556)
Financing				
Issuance of share capital	-	3,382,998	-	3,382,998
Share issue costs	-	(90,223)	-	(90,223)
Proceeds from Convertible Loan	169,631	-	2,367,531	-
Cash flows provided by financing activities	169,631	3,292,775	2,367,531	3,292,775
Effect of foreign exchange on cash and cash equivalents	(3,126)	45,350	2,918	5,552
Net increase (decrease) in cash and cash equivalents	(515,724)	2,910,269	(281,852)	2,334,739
Cash and cash equivalents, beginning of period	915,206	1,651,299	681,334	2,226,829
Cash and cash equivalents, end of period	$ 399,482	$ 4,561,568	$ 399,482	$ 4,561,568

The accompanying notes are an integral part of these condensed consolidated interim financial statements

Azabache Energy Inc.

Condensed Consolidated Interim Statement of Changes in Equity

(in Canadian dollars)
(unaudited)

	Share Capital	Contributed Surplus	Accumulated other Comprehensive Income (Loss)	Deficit	Total Equity
Balance at June 30, 2013	$ 76,003,517	4,444,012	(3,288,436)	(55,849,725)	$ 21,309,368
Loss for the period	-	-	-	(791,627)	(791,627)
Share-based payments	-	213,750	-	-	213,750
Other comprehensive loss for the period	-	-	(1,030,473)	-	(1,030,473)
Balance at September 30, 2013	76,003,517	4,657,762	(4,318,909)	(56,641,352)	19,701,018
Loss for the period	-	-	-	(4,928,070)	(4,928,070)
Private placement	3,972,299	-	-	-	3,972,299
Cost of share issuance	(110,553)	-	-	-	(110,553)
Loan conversion	350,000	-	-	-	350,000
Share-based payments	-	654,305	-	-	654,305
Other comprehensive loss for the period	-	-	(1,407,898)	-	(1,407,898)
Balance at June 30, 2014	80,215,263	5,312,067	(5,726,807)	(61,569,422)	18,231,101
Loss for the period	-	-	-	(2,687,560)	(2,687,560)
Share-based payments	-	358,931	-	-	358,931
Other comprehensive loss for the period	-	-	370,294	-	370,294
Balance at December 31, 2014	$ 80,215,263	$ 5,670,998	$ (5,356,513)	$ (64,256,982)	$ 16,272,766

The accompanying notes are an integral part of these condensed consolidated interim financial statements

1. Corporate Information

Azabache Energy Inc. ("Azabache" or "the Company") is incorporated under the Canada Business Corporations Act. The Company is an exploration stage entity. Its principal business activity is to pursue oil and gas exploration opportunities in South America, primarily in Argentina and Colombia.

The Company is listed on the TSX Venture Exchange, having the symbol AZA, as a Tier 2 oil and gas issuer.

2. Basis of Preparation

Going Concern

While these condensed consolidated interim financial statements have been prepared on the basis that the Company will continue as a going concern, which assumes that the Company will realize assets and discharge liabilities in the normal course of operations for the foreseeable future, there are events and conditions that raise significant doubt on the validity of this assumption. During the six months ended December 31, 2014 the Company had a comprehensive loss of $2,317,266 and, as at that date, had an accumulated deficit of $64,256,982. Presently, Azabache has no production.

At December 31, 2014 the Company had a working capital deficiency of $5,294,098 and management estimates that it presently does not have adequate working capital to fund all of its planned activities for the remainder of this fiscal year. These matters indicate the existence of a material uncertainty that may cast significant doubt about the ability of the Company to continue to meet its obligations as they become due. The Company currently relies on equity financing and farming out interests in its properties to other companies to maintain its ongoing exploration programs and property commitments and for administrative purposes. Due to recent government decrees from the Argentine government, there is considerable uncertainty with respect to the investment climate in that country. Since the majority of the Company's planned activities and operations are in Argentina, this uncertainty may impair the ability of the Company to raise additional equity funding or to secure suitable arrangements with other companies to develop its properties. The Company's ability to continue operations is dependent on its ability to secure this additional funding. Management's plan is to enter into arrangements with other companies to jointly develop its properties and to raise additional equity as required. The success of these initiatives cannot be assured.

These condensed consolidated interim financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary if the going concern assumption were deemed to be inappropriate. These adjustments could be material.

Statement of Compliance

The Company prepares its financial statements in accordance with International Accounting Standard ("IAS") *34 Interim Financial Reporting*. These condensed consolidated interim financial statements have been prepared following the same accounting policies and methods of computation as the annual consolidated financial statements of the Company for the year ended June 30, 2014. The disclosures below are incremental to those included with the annual consolidated financial statements and certain disclosures, which are normally required to be included in the notes to the annual consolidated financial statements, have been condensed or omitted.

These condensed consolidated interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual filings for the year ended June 30, 2014. The condensed consolidated interim financial statements were authorized for issuance by the Board of Directors on March 2, 2015.

2. Basis of Preparation (continued)

Basis of Measurement

These condensed consolidated interim financial statements have been prepared on a historical cost basis except for financial instruments which are measured at fair value. The condensed consolidated interim financial statements are presented in Canadian dollars, unless otherwise indicated, which is the Company's functional and presentation currency.

The preparation of financial statements in compliance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Significant estimates and judgment used in the preparation of the financial statements are described in Note 4 to the Company's consolidated annual financial statements for the year ended June 30, 2014.

3. Restricted Cash

Restricted cash consists of term deposits held as security for stand-by letters of credit or as guarantees related to the Company's exploration and evaluation assets. At December 31, 2014, restricted cash consists primarily of:

(a) Colombian Pesos (COP) 836,120,000 ($410,366) (June 30, 2014 - COP 836,120,000 ($474,906)) in term deposits held as security for standby letters of credit to support guarantees pursuant to the terms of the La Mona hydrocarbons exploration and production contract in Colombia. The term deposits mature in July 2015 and bear interest at rates between 4.95% and 5.50% per annum.

(b) COP 3,560,864,840 ($1,747,664) (June 30, 2014 - COP 4,886,362,973 ($2,775,397)) deposited in trust with a Colombian bank in favour of the Agencia Nacional de Hidrocarburos of Colombia ("ANH") to guarantee the completion of Phase 1 of the La Mona exploration and production contract. These funds have no fixed maturity date and bear interest at variable rates.

(in Canadian dollars)

4. Exploration and Evaluation Assets

	Colombia	Argentina	Total
Cost			
At June 30, 2013	$ 6,732,602	16,501,529	$ 23,234,131
Additions	316,490	9,461,585	9,778,075
Proceeds	(274,457)	(2,288,206)	(2,562,663)
Effect of movement in exchange rates	251,901	(6,959,631)	(6,707,730)
Balance at June 30, 2014	7,026,536	16,715,277	23,741,813
Additions	434,759	792,764	1,227,523
Proceeds	-	2,288,206	2,288,206
Effect of movement in exchange rates	(553,075)	230,778	(322,297)
Balance at December 31, 2014	$ 6,908,220	$ 20,027,025	$ 26,935,245
Impairment losses			
At June 30, 2013	$ (5,039,253)	$ (477,219)	$ (5,516,472)
Impairment provision	(1,306,597)	-	(1,306,597)
Effect of movement in exchange rates	(196,488)	156,056	(40,432)
Balance at June 30, 2014	(6,542,338)	(321,163)	(6,863,501)
Impairment provision	-	-	-
Effect of movement in exchange rates	619,721	140,396	760,117
Balance at September 30, 2014	$ (5,922,617)	$ (180,767)	$ (6,103,384)
Net book value			
At June 30, 2013	$ 1,693,349	$ 16,024,310	$ 17,717,659
At June 30, 2014	$ 484,198	$ 16,394,114	$ 16,878,312
At December 31, 2014	$ 985,603	$ 19,846,258	$ 20,831,861

The amounts capitalized as Argentina E&E assets at December 31, 2014 before impairment losses include $2,308,468 of VAT (June 30, 2014 - $2,248,206).

Colombia

Antares

The Company entered into agreements with Petróleos Del Mar ("Petromar") to farm into the Antares Block (an exploration block located in the Upper Magdalena Basin, Colombia). Petromar acquired its interest in the Antares Block pursuant to an exploration and production contract (the "Antares E&P Contract") between Petromar and the ANH. The Antares E&P Contract is currently in Phases 4 and 5 (unified) which required the drilling of two exploratory wells prior to September 25, 2011. On September 20, 2011 Petromar and the ANH executed an amendment to the Antares E&P Contract in order to suspend the current period of Phases 4 and 5 (unified) until authorities resolved the environmental authorizations to drill the two exploratory wells.

4. Exploration and Evaluation Assets (continued)

Under the agreements, the Company acquired a fifty percent (50%) working interest in the Antares Block and the Antares E&P Contract. The farm-in agreement ("FOA") is divided into the following 3 phases; (i) the drilling of the Lemaya-1 exploratory well, (ii) the drilling of the La Mona-1 exploratory well and (iii) the completion of a 3D seismic program. During the 1st quarter of fiscal 2013, Petromar drilled the Lemaya-1 well. In addition to using previously escrowed funds, the Company paid an additional US$947,399 into escrow and applied the balance owing under the loan made to an affiliate of Petromar and related interest (see Note 5). The well tested no hydrocarbons in the target formation (Caballos). The Company and the operator have decided to abandon the well.

The permits for the drilling of the La Mona-1 well were not obtained as required under the FOA and, as a result, the Company is no longer committed to fund 100% of the costs of the La Mona-1 well and a 3D seismic acquisition program.

The remaining commitment under Phases 4 and 5 (unified) is to drill a second exploratory well. Since it is unlikely that permits will be issued for the drilling of that well due to the encroachment of a proposed regional park, the operator is negotiating changes to the Antares E&P Contract that would substitute the completion of a 3D seismic acquisition program, provided new well locations will be approved, for the well.

Based on the current status of the negotiations and the difficulties being encountered in resolving environmental and other issues related to continued development of the area, the Company believes that it is unlikely that it will be able to continue its work on the Antares Block. Although the operator and the Company will pursue resolution of the issues involved and seek compensation for the effects of the delays, the Company has made provisions in prior years for impairment of the costs capitalized for the block.

La Mona

On June 29, 2010, the Company entered into an Exploration and Production Contract ("La Mona E&P Contract") with the ANH to explore for, develop and produce hydrocarbons in the La Mona Block (an exploration block located in the Lower Magdalena Basin, Colombia). The La Mona E&P Contract is currently in Phase 1 which required the drilling of an exploratory well to be started prior to February 29, 2012. Due to general delays in obtaining environmental permits in Colombia and prior to February 29, 2012, the Company requested an extension of Phase 1. Phase 2 would require that the Company acquire and process 85 line-km of 2D seismic data within 10 months of February 29, 2012.

On November 30, 2012 the ANH approved a resolution through which AZA obtained an extension term for Phase 1. The extension is for 145 days after the environmental licence is issued. The environmental licence has been approved in December 2014.

At September 30, 2014, the Company had $2,588,000 (Note 3) in escrow with the ANH to guarantee the completion of the Phase 1 of the E&P Contract.

4. Exploration and Evaluation Assets (continued)

Argentina

Covunco / El Corte

El Corte

In December 2013, the Company entered into a Participation Agreement (the "PA") with Rio Bravo Commercial Enterprises Inc. ("RBE"), a private Panamanian corporation which, together with its affiliates, owns and operates oil and gas interests in Colombia. Pursuant to the PA and its amendments, RBE was to pay US$5,000,000 in exchange for earning a 23.76% working interest (directly or indirectly) in the Covunco Norte-Sur and El Corte joint operating agreements and contracts in the Province of Neuquén (the "Contracts").

Under the agreements and their amendments, RBE paid US$500,000 upon closing, US$500,000 in March 2014 and US$1,100,000 in May 2014. The remaining amount owing of US$3,000,000 was due before the end of June 2014. RBE's interest was not to be earned unless all of the payments were made. At June 30, 2014, the $2,288,206 (US$2,100,000) was recorded as a reduction of exploration and evaluation assets.

On July 25, 2014, RBE and the Company entered into a Termination and Mutual Release Agreement ("Termination Agreement") and a Loan Agreement. Under the Termination Agreement, Azabache and RBE agree to the early termination of the PA. In consideration for the early termination, RBE paid US$1,100,000 to the Company.

At the same time, the Parties entered into a Loan Agreement whereby the entire amount paid by RBE under the PA and the Termination Agreement was converted to a convertible loan from RBE to Azabache (see Note 6). $2,288,206 (US$2,100,000) received prior to June 30, 2014 was reclassified as a loan.

El Corte

During fiscal 2012, the Company paid a success fee to a non-related third party for assisting in the acquisition of additional areas in the El Corte block. This success fee superseded an earlier success fee structured as a Net Profits Interest over the original El Corte area. Payments totaling $1,203,130 were made in December 2011 and January 2012 in respect of the original Net Profits Interest. In addition the Company agreed to pay a success fee for assisting with the acquisition of the new 18,800 hectare area in the El Corte Block, structured as a 1.5% gross overriding royalty over the new area. Until November 22, 2013, the Company had the right to acquire the 1.5% royalty interest for a payment of US$2.36 million and if the Company did not exercise this right the holder could require the Company to purchase the royalty for US$2.36 million for a period of 30 days from that date. The parties agreed to extend these dates until December 22, 2014 and January 22, 2015 respectively in exchange for the Company making monthly payments of US$35,000 until February 2014 and US$45,000 from then until November 2014. Amounts paid will be deducted from the final settlement on the sale of the royalty interest.

The second exploration period for the El Corte exploration block ended in May 2014. To maintain the block the Company had committed to drill one exploration well during that exploration period and has signed surety bonds in the amount of US$300,000 as a guarantee directly related to the commitment to drill that well.

In May 2014, the Company submitted a proposal to the provincial authorities to combine the 2nd and 3rd exploration periods for El Corte. In addition to completing the requirements of the 2nd exploration period, the proposal would include the relinquishment of 50% of the acreage in El Corte and a commitment to an exploration investment program consisting of the drilling, completion and hydraulic fracturing of one exploratory well and completion of a 100 km^2 3D seismic program.

4. Exploration and Evaluation Assets (continued)

Both programs would need to be completed by May 11, 2016.

Covunco Norte

The Covunco Norte Block ("CVN") is an exploitation concession of 17 km^2 in the Neuquén Basin in the province of Neuquén. In March 2012, the province of Neuquén mandated relinquishment of the Company's interest in the CVN block. In February 2013, the governor of Neuquén signed a decree that returned this area to the Company as part of the Covunco Norte-Sur exploration block.

Covunco Norte-Sur

During fiscal 2012 the Company drilled the Cvo.x-2 Vaca Muerta well. Under the decree that returned the CVN block to the Company, the third exploration period of this block was extended to April 22, 2013 during which the Company was to have completed the fracture stimulation of the Cvo.x-2 well. The Company agreed to assign a 10% working interest to the provincial oil & gas company, Gas y Petróleo de Neuquén S.A. ("G&P") as part of the arrangement.

In April 2013, the Company received approval from the Province for a one year extension (the "Extension") to its "high-risk" exploration permit on the Block.

In January 2014, the Company completed the fracture stimulation operation at the Cvo.x-2 well. This stimulation satisfied the remaining commitments under the Company's permit. As a result of the completion and results of the fracture stimulations, the Company has requested an extended evaluation period from the Province of Neuquén, which would be granted for a period of up to 5 years. The proposal involves a 135 km^2 acreage relinquishment and firm commitments to carrying out 2 fracture stimulations on existing wells, conducting 3D seismic studies and the drilling of at least one more unconventional well over the next two years.

Loma El Divisadero

Loma El Divisadero is an exploitation concession in the Neuquén Basin in the province of Mendoza. In order to keep the Loma El Divisadero Block in good standing, the Company is required to pay annual lease fees. Payment of these fees is pending the completion of the ownership agreements with appropriate authorities. As at September 30, 2014, the Company would be required to pay $537,000 (ARG 4,064,947) with respect to those fees for payments due on January 31 on each of the years from 2009 to 2014. As the ownership has not been confirmed, these amounts are not recorded in the Company's accounts.

Title to the Loma El Divisadero block has been pending government approval for 4 years and, because of those delays, the Company has not made significant investments in that block. As a result, the Company has recorded impairment provisions in prior periods that reduce its net book value to approximately $165,000.

Azabache Energy Inc.

Notes to the Condensed Consolidated Interim Financial Statements
For the three months ended December 31, 2014
(in Canadian dollars)
(unaudited)

5. Property, Plant and Equipment

	Furniture and Fixtures	Machinery and Equipment	Leasehold Improvements	Vehicles	Software Licenses	Total
Cost						
Balance at June 30, 2013	$ 76,262	198,626	290,218	101,988	224,799	$ 891,893
Additions	-	4,601	341	-	789	5,731
Effect of movement in exchange rates	(8,783)	(58,703)	(35,706)	(44,067)	(73,653)	(220,912)
Balance at June 30, 2014	67,479	144,524	254,853	57,921	151,935	676,712
Additions	-	-	3,901	-	637	4,538
Effect of movement in exchange rates	(286)	4,268	891	2,029	1,046	7,948
Balance at December 31, 2014	$ 67,193	$ 148,792	$ 255,744	$ 59,950	$ 153,618	$ 689,198
Depreciation						
Balance at June 30, 2013	$ 19,577	164,481	128,812	84,247	224,799	$ 621,916
Additions	4,592	12,634	49,443	14,540	789	81,998
Effect of movement in exchange rates	(5,150)	(54,344)	(17,789)	(40,866)	(73,653)	(191,802)
Balance at June 30, 2014	19,019	122,771	160,466	57,921	151,935	512,112
Additions	1,917	1,624	13,169	-	637	17,347
Effect of movement in exchnge rates	2,493	4,500	1,271	2,029	1,046	11,339
Balance at December 31, 2014	$ 19,993	$ 124,856	$ 168,832	$ 58,318	$ 153,618	$ 540,798
Net Book Value						
At June 30, 2013	$ 56,685	$ 34,145	$ 161,406	$ 17,741	$ -	$ 269,977
At June 30, 2014	$ 48,460	$ 21,753	$ 94,387	$ -	$ -	$ 164,600
At December 31, 2014	$ 47,200	$ 23,936	$ 86,912	$ 1,632	$ -	$ 148,400

6. Loans Payable

RBE Loan Agreement –

On July 25, 2014, RBE and the Company entered into a Termination and Mutual Release Agreement (“Termination Agreement”) and a Loan Agreement. Under the Termination Agreement, Azabache and RBE agree to the early termination of the PA. As part of the Termination Agreement, RBE paid US$1,100,000 to the Company.

On the same date, the Parties entered into a Loan Agreement whereby the entire amount paid by RBE under the PA and the Termination Agreement was converted to a convertible loan from RBE to Azabache. Provisions of the Loan Agreement include:

- Principal amount - US$3,200,000
- Interest rate – 6% per annum
- Maturity date – July 25, 2015
- Pre-Payment - Azabache is entitled to pre-pay the principal amount plus accrued interest at any time. The Company agrees to pre-pay US$1,000,000 if it completes a financing that result in net proceeds in excess of US$15,000,000 or a farm-out of any assets which includes a cash payment in excess of US$5,000,000.
- Conversion Rights - subject to TSX Venture Exchange (“TSXV”) and shareholder approval, if required, Azabache may convert the principal plus interest into Common Shares of the Company at any time after April 21, 2015.
- Conversion Price – the greater of the volume-weighted average trading price of the Common Shares for a 30 day period prior to conversion or the “Market Price” as defined by the TSXV.
- Loan Conversion - if required approvals of the TSXV or the Company’s shareholders are not obtained within 6 months of the date of the notification of the conversion, Azabache has the option to repay the principal and interest in full or to convert the principal plus interest into a new loan maturing 2 years from the date of the notice of conversion with an interest rate of 10% per annum.

$1,000,000 convertible loan –

On September 19, 2014, the Company closed a non-brokered financing (the "Debt Offering") of a $1,000,000 convertible, unsecured interest-bearing loan (the "Convertible Loan") with an insider of the Company.

The Convertible Loan will bear interest at a rate of 8% per annum, calculated and payable together with the principal of the Convertible Loan upon the maturity date. The term of the Convertible Loan shall be one (1) year, with the Company having a right to prepayment at any time. At maturity, the Convertible Loan may be convertible into Common Shares of the Company at a conversion price of $0.16 per share.

(in Canadian dollars)

7. Decommissioning Provision

The Company estimates that, at September 30, 2014, the total undiscounted cash flows required to settle its decommissioning obligation is approximately $3,500,000. The majority of the costs are expected to be incurred between 2015 and 2021. The decommissioning obligation has been estimated using existing technology at current prices and discounted using discount rates that reflect current market assessments of the time value of money and the risks specific to each liability.

8. Share Capital and Reserves

Capital Stock

(a) Authorized

Unlimited number of common shares without par value
Unlimited number of voting special shares

(b) Issued

Common Shares	**Number**		**Amount**
Balance issued at June 30, 2013	145,042,436	$	76,003,517
Private placement	30,556,140		3,972,299
Cost of share issuance	-		(110,553)
Balance issued at June 30, 2014	175,598,576	$	79,865,263
Issued on conversion of loan (Note 8)	2,058,823		350,000
Balance issued at September 30, 2014	177,657,399	$	80,215,263

In December 2013 and January and February 2014, the Company completed a private placement in three tranches. The private placement consisted of 30,556,140 units at a price of $0.13 per unit for gross proceeds of $3,972,299. Each unit consists of one common share and one-half of one common share purchase warrant. Each full warrant entitles the holder to purchase an additional common share at a price of $0.18 per share for a period of 24 months from closing of the private placement. Net proceeds of the private placement were $3,861,746.

(in Canadian dollars)

9. Share-Based Payments

(a) Option Plan Details

The Company has an incentive Stock Option Plan ("the Plan") under which non-transferrable options to purchase common shares of the Company may be granted to directors, officers, employees or service providers of the Company. Under the Plan the maximum number of Common Shares reserved for issue shall not exceed, in aggregate, 10 percent of the number of Common Shares outstanding. The terms of the Plan provide that the Directors have the right to grant options to acquire common shares of the Company at not less than the closing market price of the shares on the day preceding the grant at terms of up to ten years. Vesting of the options is dependent on either the Company meeting certain stock price performance goals or the individual meeting certain job performance criteria. As at December 31, 2014, the Company had 7,440,740 (June 30, 2014 – 6,934,858) options available for issuance under the plan.

A summary of stock options outstanding at December 31, 2014 is as follows:

Exercise Price	Number	Remaining Life
$0.33	700,000	1.05 Years
$0.68	300,000	1.95 Years
$0.13	7,375,000	4.50 Years

(b) Fair Value of Options Issued During the Period

No options were granted during the three months ended December 31, 2014. The weighted average fair value at grant date of options granted during the year ended June 30, 2014 was $0.08 per option.

Options Issued to Employees and Non-Employees

The fair value at grant date is determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option, the forfeiture rate, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk free interest rate for the term of the option.

Expenses Arising from Share-Based Payment Transactions

Share based payment expense related to stock options recognized during the six months ended December 31, 2014 was $358,931 (six months ended December 31, 2013 - $424,853).

10. Segmented Information

Azabache is in the business of oil and gas exploration in Argentina and Colombia. Management has organized the Company's reportable segments by geographic area. The Argentinean and Colombian segments are responsible for that country's oil and gas exploration activities while the Canadian segment manages corporate head office activities. All intercompany transactions have been eliminated from the net loss figures below. Information concerning Azabache's reportable segments is as follows:

(in Canadian dollars)

10. Segmented Information (continued)

Consolidated Loss

Six Months Ended	December 31, 2014	December 31, 2013
Canada	$ 520,062	$ 1,061,368
Colombia	175,946	280,433
Argentina	1,991,552	1,004,302

Identifiable Assets

Six Months Ended	December 31, 2014	December 31, 2013
Canada	$ 412,617	$ 4,368,502
Colombia	4,282,754	5,163,704
Argentina	19,399,726	14,258,843

11. Finance Charges

Six months ended December 31	2014	2013
Interest and Bank Charges	$ 305,255	$ 48,471
Accretion of Loan Liability		30,407
Accretion of Decommissioning Obligation	149,795	91,964

12. Capital Management

The Company's objectives when managing capital are:

- to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders; and
- to maintain a flexible capital structure, which optimizes the cost of capital, at an acceptable risk.

The capital structure of the Company is currently defined as shareholders' equity, which is comprised of share capital, contributed surplus and deficit.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company, subject to approval of the Board of Directors, may attempt to issue new shares, issue new debt or acquire or dispose of assets. The Company is not exposed to externally imposed capital restrictions and has no debt facilities.

The Company will use its existing capital resources and, if available, future equity issues, farmouts and asset sales to meet its financial commitments, including planned exploration on its properties and administrative expenditures. The Company reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

13. Financial Instruments and Financial Risk Management

A summary of the Company's risk exposures as it relates to financial instruments are reflected below:

(a) Credit Risk

The Company is exposed to credit risk in relation to its cash and cash equivalents, restricted cash, accounts receivable and certain of its deposits.

Cash and cash equivalents and restricted cash are held with highly rated Canadian and international banks or government institutions, and therefore the Company does not believe these financial instruments are subject to material credit risk.

The Company's accounts receivable are exposed to the risk of financial loss if the counterparty fails to meet its contractual obligations and are subject to normal industry credit risk. The carrying amounts of these items represent the Company's maximum credit exposure. The Company has no past due accounts receivable that are not provided for.

(b) Interest Rate Risk

The Company invests cash surplus to its operational needs in investment-grade short-term deposit certificates issued by its banks. Interest rate cash flow risk is not significant.

(c) Foreign Currency Risk

The Company's exploration and evaluation activities are substantially denominated in Canadian and US dollars and Argentinean and Colombian Pesos. The Company's funds are predominantly kept in the same currencies with major financial institutions. The Company's reporting currency is the Canadian dollar; however major purchases are transacted in Canadian dollars, Argentinean Pesos (ARS), Colombian Pesos (COP) and American dollars (USD). The Company does not hedge its foreign exchange risk.

(d) Liquidity Risk

The Company monitors its liquidity position regularly to assess whether it has the resources necessary to fund planned exploration commitments on its exploration and evaluation assets or that viable options are available to fund such commitments from new equity issuances or alternative sources of financing such as farm-out agreements. However, as an exploration company without internally generated cash flow, there are inherent liquidity risks, including the possibility that additional financing may not be available to the Company, or that actual exploration expenditures may exceed those planned. Alternatives available to the Company to manage its liquidity risk include deferring planned capital expenditures that exceed amounts required by work programs to retain concession licences, farm-out arrangements and securing new equity or debt capital. Liquidity risk arises primarily from accounts payable and accrued liabilities and commitments. The Company's accounts payable and accrued liabilities are generally due within 60 days.

14. Commitments

The Company's commitment for office space and rental accommodation for the remainder of this fiscal year is $35,000.

The Company is required to complete various work programs to maintain the rights under its land holding agreements. These commitments are described in Note 4.

15. Related Party Transactions

Certain officers and directors provide consulting services to the Company. For the six months ended December 31, 2014, these expenditures totaled $131,523 (three months ended December 31, 2013 - $128,258). As at December 31, 2014 accounts payable and accrued liabilities include $28,880 in amounts due to related parties.