



RUSSELL BREWERIES INC.

**CONDENSED CONSOLIDATED INTERIM
FINANCIAL STATEMENTS**

**FOR THE THREE AND SIX MONTHS ENDED
DECEMBER 31, 2013 AND 2012**

UNAUDITED

NOTICE OF NO AUDITOR REVIEW OF CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed consolidated interim financial statements of the Company have been prepared by, and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of the financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of financial statements by an entity's auditor.

RUSSELL BREWERIES INC.**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION****(Unaudited; Expressed in Canadian Dollars)**

	December 31, 2013	June 30, 2013
ASSETS		
Current		
Cash and cash equivalents	\$ 244,923	\$ 213,452
Accounts receivable	918,493	1,124,666
Inventories (Note 4)	610,687	664,046
Prepaid expenses and deposits	141,190	143,981
Due from related parties (Note 16)	–	17,738
	1,915,293	2,163,883
PROPERTY AND EQUIPMENT (Note 5)	2,664,477	2,849,850
INTANGIBLE ASSETS (Note 6)	1,935,268	1,935,268
RESTRICTED TERM DEPOSITS (Note 7)	100,000	100,000
LONG-TERM INVESTMENT (Note 8)	100,000	100,000
	\$ 6,715,038	\$ 7,149,001
LIABILITIES		
Current		
Bank indebtedness (Note 18(c))	\$ –	\$ 36,671
Accounts payable and accrued liabilities	1,098,550	1,416,363
Due to related parties (Note 16)	209,417	105,662
Current portion of long-term debt (Note 9)	468,863	966,226
Current portion of finance lease obligations (Note 10)	32,329	32,329
	1,809,159	2,557,251
LONG-TERM DEBT (Note 9)	230,197	68,609
FINANCE LEASE OBLIGATIONS (Note 10)	49,348	68,131
UNEARNED LICENSE FEES (Note 11)	68,750	81,250
DEFERRED TAX LIABILITIES	729,000	729,000
	2,886,454	3,504,241
SHAREHOLDERS' EQUITY		
SHARE CAPITAL	11,782,704	11,783,304
SHARE-BASED PAYMENTS RESERVES	3,397,533	3,398,726
DEFICIT	(11,351,653)	(11,537,270)
	3,828,584	3,644,760
	\$ 6,715,038	\$ 7,149,001
NATURE OF OPERATIONS AND GOING CONCERN (Note 1)		
COMMITMENTS AND CONTINGENCIES (Note 18)		
SUBSEQUENT EVENTS (Note 22)		

Approved on behalf of the Board of Directors on February 26, 2014:

/s/ Benjamin Li Yu

Benjamin Li Yu, Director

/s/ Peter H. Stafford

Peter H. Stafford, Director

RUSSELL BREWERIES INC.**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF COMPREHENSIVE LOSS****(Unaudited; Expressed in Canadian Dollars)**

	Three Months Ended December 31, 2013	Three Months Ended December 31, 2012	Six Months Ended December 31, 2013	Six Months Ended December 31, 2012
REVENUES (Note 20)	\$ 2,537,387	\$ 1,984,546	\$ 5,014,674	\$ 4,309,628
LESS: EXCISE TAX AND PROVINCIAL MARK-UP	565,797	474,016	1,102,614	992,309
NET REVENUES	1,971,590	1,510,530	3,912,060	3,317,319
COST OF SALES (Note 4)	876,719	586,023	1,658,660	1,470,869
GROSS MARGIN	1,094,871	924,507	2,253,400	1,846,450
EXPENSES				
Depreciation	19,452	36,409	44,938	71,766
Selling, general and administrative	959,876	909,712	1,954,954	1,764,553
	979,328	946,121	1,999,892	1,836,319
EARNINGS/(LOSS) BEFORE OTHER INCOME (EXPENSE)	115,543	(21,614)	253,508	10,131
OTHER INCOME (EXPENSE)				
Interest on long-term debt and convertible debt	(29,910)	(66,342)	(80,445)	(161,828)
Interest Income	—	263	54	596
Other income (Note 11)	6,250	—	12,500	—
	(23,660)	(66,079)	(67,891)	(161,232)
PROFIT/(LOSS) BEFORE INCOME TAXES	91,883	(87,693)	185,617	(151,101)
INCOME TAXES				
Deferred income tax expense	—	—	—	—
NET PROFIT/(LOSS) AND COMPREHENSIVE PROFIT/(LOSS) FOR THE PERIOD	91,883	(87,693)	185,617	(151,101)
EARNINGS/(LOSS) PER SHARE (Note 14)				
Basic and diluted	\$ 0.00	\$ (0.00)	\$ 0.00	\$ (0.00)

RUSSELL BREWERIES INC.

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY

(Unaudited; Expressed in Canadian Dollars)

	Share Capital		Allotted Shares	Convertible Debentures	Preferred Shares	Share-based payments reserves	Deficit	Total Shareholders' Equity
	Number of Shares	Value						
Balance, July 1, 2013	78,350,455	\$11,783,304	\$0	\$0	\$0	\$3,398,726	\$(11,537,270)	\$3,644,760
Comprehensive income for the period	—	—	—	—	—	—	185,617	185,617
Share issue cost adjustment	—	(600)	—	—	—	—	—	(600)
Fair value of stock options granted	—	—	—	—	—	(1,193)	—	(1,193)
Balance, December 31, 2013	78,350,455	\$11,782,704	\$0	\$0	\$0	\$3,397,533	\$(11,351,653)	\$3,828,584

	Share Capital		Allotted Shares	Convertible Debentures	Preferred Shares	Share-based payments reserves	Deficit	Total Shareholders' Equity
	Number of Shares	Value						
Balance, July 1, 2012	62,230,562	\$9,772,163	\$5,440	\$86,484	\$518,979	\$3,361,624	\$(10,729,851)	\$3,014,839
Comprehensive loss for the period	—	—	—	—	—	—	(151,101)	(151,101)
Conversion of convertible debentures	4,938,333	827,234	—	(86,484)	—	—	—	740,750
Fair value of stock options granted	—	—	—	—	—	40,391	—	40,391
Dividends on preferred shares	—	—	—	—	—	—	(20,400)	(20,400)
Balance, December 31, 2012	67,168,895	\$10,599,397	\$5,440	\$0	\$518,979	\$3,402,015	\$(10,901,352)	\$3,624,479

RUSSELL BREWERIES INC.**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS****(Unaudited; Expressed in Canadian Dollars)**

	Six Months Ended December 31, 2013	Six Months Ended December 31, 2012
CASH FLOWS PROVIDED BY (USED IN):		
OPERATING ACTIVITIES		
Net income/(loss) for the period	\$ 185,617	\$ (151,101)
Adjusted for non-cash items:		
Depreciation	196,600	220,000
Accretion of long-term debt	3,348	40,155
Accretion of bridge loan	6,793	—
Accretion of convertible debentures	—	71,909
Accrued interest on convertible debentures	—	(18,519)
Accretion of license fee earned	(12,500)	—
Share-based compensation	(1,193)	40,391
	378,665	202,835
Net changes in non-cash working capital items:		
Accounts receivable	206,173	279,875
Prepaid expenses and deposits	2,791	(154,143)
Inventories	53,359	9,088
Due to and from related parties	14,700	65,710
Accounts payable and accrued liabilities	(317,813)	(119,609)
	337,875	283,756
INVESTING ACTIVITIES		
Adjustment/Purchase of property and equipment	(11,227)	(27,085)
	(11,227)	(27,085)
FINANCING ACTIVITIES		
Share issuance cost	(600)	—
Shares issued as corporate finance fees	(6,793)	—
Bridge loan	100,000	—
Proceeds from (repayment of) bank indebtedness	(36,671)	22,436
Repayment of long-term debt	(339,123)	(69,001)
Repayment of finance lease obligations	(18,783)	(28,130)
	(295,177)	(74,695)
INCREASE IN CASH AND CASH EQUIVALENTS	31,471	181,976
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	213,452	29,199
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 244,923	\$ 211,175
CASH AND CASH EQUIVALENTS CONSIST OF:		
Demand deposits	\$ 244,923	\$ 211,175

SUPPLEMENTAL CASH FLOW INFORMATION (Note 15)

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2013 AND 2012**

(Unaudited; Expressed in Canadian Dollars)

1. NATURE OF OPERATIONS AND GOING CONCERN

Russell Breweries Inc. (the "Company") was incorporated under the laws of the Province of British Columbia, Canada on March 23, 2000. The head office and principal address of the Company are located at #202 - 13018, 80th Avenue, Surrey, British Columbia, V3W 3A8. The Company produces beer primarily for sale to provincial liquor distribution organizations and entities engaged in the food and beverage industries within Canada. The Company's shares are traded on the TSX Venture Exchange (the "TSX.V").

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. As at December 31, 2013, the Company had a positive working capital of \$106,134 and accumulated losses since inception of \$11,351,653. The continued operation of the Company is dependent on its ability to obtain financing sufficient to generate profitable operations in the future. There is no guarantee that the Company will be able to raise this additional financing.

2. STATEMENT OF COMPLIANCE AND BASIS OF PRESENTATION**a) Statement of Compliance**

These consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. These financial statements do not include all of the information required for full annual financial statements.

The condensed consolidated interim financial statements were authorized for issuance by the Board of Directors on February 26, 2014.

b) Presentation and Functional Currency

These consolidated financial statements are presented in Canadian dollars. Under IFRS, the Canadian dollar is the functional currency of the Company and its wholly-owned subsidiaries, Russell Brewing Company Ltd. located in Surrey, British Columbia and Fort Garry Brewing Company Ltd. located in Winnipeg, Manitoba.

c) Basis of Measurement

Depending on the applicable IFRS requirements, the measurement basis used in the preparation of these financial statements is cost, net realizable value, fair value or recoverable amount.

d) Significant Accounting Estimates and Judgments

The preparation of these condensed interim financial statements requires management to make estimates and judgments 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 revenues and expenses for the reporting period. Significant areas requiring the use of management estimates may include recovery of accounts receivable, inventory valuation, the estimated useful life of long-lived assets, the recoverability of amounts recorded for long-lived assets, estimates used in impairment analysis of long-lived assets, container liabilities, valuation of deferred tax assets and liabilities and estimates used in calculating share-based compensation. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant. Actual results could differ from management's best estimates as additional information becomes available.

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2013 AND 2012**

(Unaudited; Expressed in Canadian Dollars)

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies that have been used in the preparation of these condensed interim financial statements are summarized in the audited consolidated financial statements of the Company for the year ended June 30, 2013. These statements should be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2013.

4. INVENTORIES AND COST OF SALES

	December 31, 2013	June 30, 2013
Finished goods	\$ 89,925	\$ 113,662
Work-in-progress	192,463	190,540
Raw materials	328,299	359,844
	\$ 610,687	\$ 664,046

The cost of sales of the Company is broken down into its cash and non-cash components as follows:

	Three Months Ended December 31, 2013	Three Months Ended December 31, 2012	Six Months Ended December 31, 2013	Six Months Ended December 31, 2012
Operating expenses	\$ 800,801	\$ 518,333	\$ 1,506,998	\$ 1,322,635
Depreciation	75,918	67,690	151,662	148,234
	\$ 876,719	\$ 586,023	\$ 1,658,660	\$ 1,470,869

RUSSELL BREWERIES INC.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2013 AND 2012

(Unaudited; Expressed in Canadian Dollars)

5. PROPERTY AND EQUIPMENT

	Computer		Equipment		Leasehold improvements		Office furniture and fixtures		Vehicles		Returnable containers		Total
Cost													
Balance as at July 1, 2012	\$	69,285	\$	5,913,242	\$	1,307,826	\$	63,844	\$	519,599	\$	863,772	\$ 8,737,568
Additions		—		48,461		1,731		—		42,815		31,867	124,874
Balance as at June 30, 2013	\$	69,285	\$	5,961,703	\$	1,309,557	\$	63,844	\$	562,414	\$	895,639	\$ 8,862,442
Additions		—		—		—		—		—		—	—
Balance as at December 31, 2013	\$	69,285	\$	5,961,703	\$	1,309,557	\$	63,844	\$	562,414	\$	895,639	\$ 8,862,442
Accumulated Depreciation													
Balance as at July 1, 2012	\$	69,009	\$	3,092,442	\$	1,275,121	\$	59,878	\$	347,404	\$	726,128	\$ 5,569,982
Depreciation		276		288,288		32,750		3,966		54,921		62,409	442,610
Balance as at June 30, 2013	\$	69,285	\$	3,380,730	\$	1,307,871	\$	63,844	\$	402,325	\$	788,537	\$ 6,012,592
Depreciation		—		124,294		173		—		28,780		32,126	185,375
Balance as at December 31, 2013	\$	69,285	\$	3,505,024	\$	1,308,044	\$	63,844	\$	431,105	\$	820,663	\$ 6,197,965
Carrying amounts													
July 1, 2012	\$	276	\$	2,820,800	\$	32,705	\$	3,966	\$	172,195	\$	137,644	\$ 3,167,586
June 30, 2013	\$	—	\$	2,580,973	\$	1,686	\$	—	\$	160,089	\$	107,102	\$ 2,849,850
December 31, 2013	\$	—	\$	2,456,679	\$	1,513	\$	—	\$	131,309	\$	74,976	\$ 2,664,477

Equipment includes assets under finance leases with a cost of \$439,720 (June 30, 2013 – \$439,720) and accumulated depreciation of \$101,213 (June 30, 2013 – \$88,650). Vehicles includes assets under finance leases with a cost of \$537,508 (June 30, 2013 – \$537,508) and accumulated depreciation of \$387,857 (June 30, 2013 – \$363,122).

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2013 AND 2012**

(Unaudited; Expressed in Canadian Dollars)

6. INTANGIBLE ASSETS

	Brands and Trademarks	Website	Total
Cost			
Balance as at July 1, 2012	\$ 1,935,268	\$ 5,975	\$ 1,941,243
Balance as at June 30, 2013	\$ 1,935,268	\$ 5,975	\$ 1,941,243
Balance as at December 31, 2013	\$ 1,935,268	\$ 5,975	\$ 1,941,243
Accumulated Depreciation			
Balance as at July 1, 2012	\$ –	\$ 5,975	\$ 5,975
Balance as at June 30, 2013	\$ –	\$ 5,975	\$ 5,975
Balance as at December 31, 2013	\$ –	\$ 5,975	\$ 5,975
Carrying amounts			
July 1, 2012	\$ 1,935,268	\$ –	\$ 1,935,268
June 30, 2013	\$ 1,935,268	\$ –	\$ 1,935,268
December 31, 2013	\$ 1,935,268	\$ –	\$ 1,935,268

7. RESTRICTED TERM DEPOSITS

A term deposit of \$100,000 has been pledged as security for a \$100,000 bank line of credit (June 30, 2013 – \$100,000).

8. LONG-TERM INVESTMENT

On October 9, 2012, the Company completed a non-exclusive technology and trade mark license agreement (“License Agreement”) with Russell Breweries (China) Inc. (the “Licensee”). Pursuant to the License Agreement, the Company subscribed for 20% of the common shares of the Licensee (“Licensee Common Shares”) for \$100,000.

The Company has used the cost method to account for its \$100,000 subscription for a 20% interest in common shares of the Licensee as a long-term investment due to the fact that the Company has no significant influence over the Licensee’s management of operations (see Note 11).

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2013 AND 2012**

(Unaudited; Expressed in Canadian Dollars)

9. LONG-TERM DEBT

	December 31, 2013	June 30, 2013
Term bank loan, bearing interest at a floating base rate plus a variance of 1%, repayable in monthly installments of \$9,750 plus interest prior to October 2010 and thereafter repayable in monthly installments of \$9,750 plus interest maturing November 15, 2014, secured by the assets of Fort Garry (a)	\$ 111,860	\$ 165,750
Term bank loan, bearing interest at floating base rate plus a variance of 1%, repayable in monthly installments of \$1,750 plus interest maturing August 15, 2015, secured by the assets of Fort Garry (b)	27,478	40,859
Discount loan, bearing interest at 10% per annum compounded semi-annually, \$836,834 due July 31, 2013, secured by the assets of Russell and Fort Garry (c)	–	828,226
Term loan, bearing interest at 10% per annum calculated semi-annually, repayable in monthly installments of \$17,500 plus interest maturing on July 31, 2016, secured by the assets of Russell and Fort Garry (c)	559,722	–
	699,060	1,034,835
Less: current portion of long-term debt	(468,863)	(966,226)
Long-term portion of long-term debt	\$ 230,197	\$ 68,609

- (a) On December 8, 2008, the bank made an amendment to the existing term loan in accordance with the request of the Company for a six month principal postponement. Pursuant to the amendment, the remaining loan amount on December 8, 2008 of \$787,500 was to be repaid by 42 consecutive monthly principal installments of \$18,750 each commencing June 15, 2009 and ending November 15, 2012. The bank also granted a reduction of the interest rate on the term loan by 1%. With the exception of the amendments agreed, all terms and conditions of the term loan remain unchanged. On September 22, 2010, the bank made a further amendment to the existing term loan in accordance with the request of the Company. Pursuant to the amendment, the remaining loan amount is to be repaid by 50 consecutive monthly principal installments of \$9,750 each commencing October 15, 2010 and ending November 15, 2014.
- (b) On October 5, 2010, the Company's subsidiary Fort Garry Brewing Company Ltd. accepted an offer of a \$100,000 pre-authorized working capital loan from Business Development Bank of Canada ("BDC"). The BDC Loan, bearing interest at floating base rate plus a variance of 1% maturing August 15, 2015, is secured by the assets of Fort Garry and supported by a guarantee made by two directors of the Company. In return for the guarantee, the Company issued 250,000 common shares of the Company as bonus shares with an estimated fair value of \$0.08 per share for a total value of \$20,000, which was recorded as a financing cost against the value allocated to the loan. During the period ended December 31, 2013, the Company recorded interest expense of \$1,728 (2012 - \$2,499) related to the accretion of the discounted value of the loan, which has been recorded as interest on long-term debt in the statement of operations.
- (c) On December 31, 2007, the Company entered into a loan agreement pursuant to which the lender, a shareholder of the Company, provided a discounted loan to the Company valued at \$1,239,000 at maturity. Under the agreement, a notional principal amount of \$965,000 was assigned to the loan. In connection with the loan, the lender was entitled to a \$25,000 bonus which was deducted from the notional principal amount of \$965,000, resulting in net proceeds to the Company of \$940,000. The Company also issued 250,000 warrants to the lender, each warrant entitling the lender to purchase one common share of the Company at a price of \$0.65 per share for a period of two years expiring on December 31, 2009.

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
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(Unaudited; Expressed in Canadian Dollars)

9. LONG-TERM DEBT (continued)

- (c) Net proceeds of \$896,040 and \$43,960 were allocated to the loan and warrants, respectively, based on their relative fair values on December 31, 2007. The Company incurred cash debt issue costs of \$14,435 which were recorded as a discount against the value allocated to the loan. The fair values of the warrants issued in connection with the loan were computed using the Black-Scholes option-pricing model. The Company may repay the loan at any time without penalty by paying the notional principal amount of \$965,000 plus accumulated interest. As at December 31, 2013, the fair value of this early settlement option was estimated to be \$nil.

On December 31, 2010, the Company entered into an amendment and loan extension agreement to the loan agreement dated December 31, 2007, pursuant to which the lender extended the maturity date to July 31, 2012 and reduced the loan amount to \$738,600 from \$1,239,000, provided that the Company repay the loan in the amount of \$619,000 on January 1, 2011 (paid). Pursuant to the amended loan agreement, the lender provides to the Company a new loan valued at maturity in the amount of \$738,600. A discounted value or loan advance amount of \$620,000 is calculated based on a 10% per annum interest rate, calculated semi-annually, with interest payable on maturity resulting in a total loan value at maturity of \$738,600. In consideration of the lender agreeing to amend and extend the loan, the lender will also earn a bonus of \$22,500 to be included in the loan amount. The term of the loan is nineteen months. The Company may repay the loan at any time without penalty by paying the discounted loan advance amount of \$620,000 together with accumulated interest.

On July 11, 2012, the Company agreed to a one year extension (the "Extension") and amendment to the loan agreement (the "Loan Agreement") dated December 31, 2007. The Extension is for one year, maturing on July 31, 2013 and bears interest at 10% per annum, calculated semi-annually. In consideration of the Lender's agreement to amend and extend the Loan, the Lender will earn a bonus (the "Bonus") of \$24,374. Russell may repay the Loan at any time without penalty by paying the Loan Advance Amount together with accumulated interest and prorated Bonus.

The Extension is guaranteed by Russell Brewing Company Ltd. and Fort Garry Brewing Company Ltd., both wholly-owned subsidiaries of the Company. As security for the Loan, the Company will grant to the Lender a subordinated security agreement creating a security interest and charge over all of their respective property and assets subordinate to senior debt and senior security of up to \$2.5 million plus finance lease obligations incurred for future acquisitions of equipment and other capital assets.

During the period ended December 31, 2013, the Company recorded interest expense of \$8,608 (2012 - \$37,656) related to the accretion of the discounted value of the loan, which has been recorded as interest on long-term debt in the statement of comprehensive loss.

Excluding finance fees and discounting, the Company's future estimated principal repayments of long-term debt are as follows:

Fiscal Year	Amount
2014	\$ 174,000
2015	279,750
2016	178,250
	\$ 632,000

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2013 AND 2012**

(Unaudited; Expressed in Canadian Dollars)

10. FINANCE LEASE OBLIGATIONS

The Company finances certain property and equipment using finance leases which bear interest at rates ranging from 6.63% to 20.58% and expire on various dates through June 2016. Estimated future minimum lease payments under these finance leases are as follows:

<u>Fiscal Year:</u>	<u>Amount</u>
2014	\$ 22,706
2015	48,277
2016	27,483
Total minimum lease payments	98,466
Less: amount representing interest	(16,789)
Net minimum lease payments	81,677
Less: current portion of finance lease obligations	(32,329)
Long-term portion of finance lease obligations	\$ 49,348

11. UNEARNED LICENSE FEES

On October 2, 2012, the Company completed a non-exclusive technology and trade mark license agreement ("License Agreement") with Russell Breweries (China) Inc. (the "Licensee") to allow the Licensee to import, produce, package, use, market, sell and distribute Russell brands in China, including Hong Kong and Taiwan.

Pursuant to the License Agreement, the Company received an initial licensing fee of \$100,000. In addition, the Company will be entitled to ongoing royalties of \$23 per hectolitre of beer produced and sold by the Licensee. The term of the agreement is for four years and expires on October 1, 2016.

During the period ended December 31, 2013, the Company has recognized \$nil in royalties and \$12,500 in license fees earned under the agreement, which has been recorded as other income in the statement of operations. As at December 31, 2013, the unearned license fee is \$68,750.

12. SHARE CAPITAL**(a) Authorized Share Capital**

The Company's authorized share capital consists of an unlimited number of common shares without par value.

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2013 AND 2012**

(Unaudited; Expressed in Canadian Dollars)

12. SHARE CAPITAL (continued)**(b) Stock Options**

Under the Company's stock option plan (the "Plan"), the Company's board of directors is authorized to grant stock options to directors, officers, consultants and employees of the Company not to exceed 10% of the issued and outstanding common shares of the Company from time to time. Stock options granted under the Plan are exercisable over a period not exceeding five years from the date granted. Exercise prices may not be less than the market price of the common shares on the date of grant less applicable discounts permitted by the TSX Venture Exchange. Vesting terms are determined by the board of directors on the date of grant.

During the period ended December 31, 2013, the Company granted nil and vested 50,000 (2012 – granted nil and vested 972,222) net of forfeited incentive stock options to key employees and directors exercisable at \$0.10 per share expiring after five years of the grant date, pursuant to its stock option plan. The fair value of each option granted was \$0.05 calculated using the Black-Scholes option-pricing model at the date of grant using the following assumptions: expected option life for 5 years; forfeiture rate of 0%~12.9%; risk-free interest rate of 0%; expected dividend yield of 0% and expected stock price volatility of 0%. During the period ended December 31, 2013, the Company recognized compensation recovery of \$1,193 (2012 – cost of \$40,391) as selling, general and administrative expense.

The estimated fair value of options granted to the Company's employees and directors is calculated at the grant date and each tranche is recognized on the graded vesting method over the period during which the options vest. The fair value of non-employee awards is estimated at each reporting period until the final measurement date.

Stock option activity during the period ended December 31, 2013 and the year ended June 30, 2013 is presented below:

	December 31, 2013		June 30, 2013	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of period	1,300,000	\$ 0.10	4,077,500	\$ 0.10
Granted	–	–	–	0.10
Expired	–	0.10	(977,500)	0.10
Forfeited	(1,250,000)	–	(1,800,000)	–
Outstanding, end of period	50,000	\$ 0.10	1,300,000	\$ 0.10

Certain directors and officers of the Company resigned resulting in forfeiture of 1,250,000 stock options as at December 31, 2013.

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12. SHARE CAPITAL (continued)**(c) Stock Options (continued)**

At December 31, 2013, the following stock options are outstanding:

Options Outstanding			Options Exercisable		
Exercise Price	Number of	Weighted Average	Weighted Average	Number of	Weighted Average
\$	Shares	Remaining Life (in years)	Exercise Price	Shares	Exercise Price
\$			\$		\$
0.10	50,000	3.25	0.10	50,000	0.10

(d) Warrants

Warrant activity during the period ended December 31, 2013 and the year ended June 30, 2013 is presented below:

	December 31, 2013		June 30, 2013	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of period	9,640,000	\$ 0.10	20,380,000	\$ 0.13
Granted	—	—	9,640,000	0.10
Exercised	—	—	—	—
Expired	—	—	(20,380,000)	0.13
Outstanding, end of period	9,640,000	\$ 0.10	9,640,000	\$ 0.10

At December 31, 2013, the following warrants were outstanding entitling the holders the right to purchase one common share for each warrant held:

Number of Warrants	Weighted Average Exercise Price	Expiry Date
9,640,000	\$ 0.10	May 17, 2015

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13. INCOME TAXES

The Company has non-capital losses of approximately \$11,431,000 which may be carried forward to apply against future years income tax for Canadian income tax purposes, subject to final determination by taxation authorities and expiring as follows:

<u>Fiscal Year of Expiry</u>	<u>Amount</u>
2014	\$ 52,000
2015	283,000
2026	257,000
2027	750,000
2028	1,696,000
2029	2,213,000
2030	1,831,000
2031	1,937,000
2032	1,572,000
2033	840,000
	\$ 11,431,000

14. PROFIT/(LOSS) PER SHARE

Net profit/(loss) attributable to common shareholders in the computation of income/(loss) per share is as follows:

	Six Months Ended December 31, 2013	Six Months Ended December 31, 2012
Net profit/(loss) and comprehensive profit/(loss)	\$ 185,617	\$ (151,101)
Dividends on exchangeable preferred shares	–	(20,400)
Net income/(loss) attributable to common shareholders	\$ 185,617	\$ (73,608)

The weighted average number of shares outstanding used in the computation of net income (loss) per share for the period ended December 31, 2013 was 78,350,455 (June 30, 2013 – 67,704,933). Outstanding stock options and warrants were excluded from the basic and diluted weighted average number of shares calculation, as their effect would have been anti-dilutive.

15. SUPPLEMENTAL CASH FLOW INFORMATION

	Six Months Ended December 31, 2013	Six Months Ended December 31, 2012
Cash paid for:		
Interest	\$ 70,304	\$ 68,283
Non-cash investing and financing activities:		
Finance lease obligations recognized for assets under finance lease	\$ –	\$ 94,898
Common shares issued for bridge loan	6,793	–

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16. RELATED PARTY TRANSACTIONS AND BALANCES

The Company has identified its directors and certain senior officers as its key management personnel and the compensation costs for key management personnel and companies related to them were recorded at their exchange amounts as agreed upon by transacting parties and on terms and conditions similar to non-related parties as follows:

The compensation costs for key management personnel and companies related to them were recorded as follows:

	Six Months Ended December 31, 2013	Six Months Ended December 31, 2012
Management and consulting fees (Notes 16(a), (b) & (c))	\$ 130,307	\$ 144,000
Directors fees (Note 16(d))	17,484	15,000
Accounting fees	33,333	62,000
Share-based payments	(1,193)	40,391
	\$ 179,931	\$ 261,391

- (a) During the period ended December 31, 2013, the Company incurred management fees of \$nil to the CEO of the Company (2012 – \$nil) and \$33,333 to a company controlled by the CEO (2012 – \$nil). As at December 31, 2013, the Company owed \$26,250 to the CEO and a company controlled by the CEO (2012 – \$nil), which is non-interest bearing, unsecured and due on demand.
- (b) During the period ended December 31, 2013, the Company incurred management and consulting fees of \$nil to the former CEO of the Company (2012 – \$nil) and \$90,200 to a company controlled by the former CEO (2012 – \$72,000). As at December 31, 2013, the Company owed \$nil to the former CEO and a company controlled by the former CEO (2012 – \$57,417), which is non-interest bearing, unsecured and due on demand.
- (c) During the period ended December 31, 2013, the Company incurred management fees of \$nil to the former COO of the Company (2012 – \$nil) and \$6,774 to a company controlled by the former COO (2012 – \$72,000). As at December 31, 2013, the Company owed \$nil to the former COO and a company controlled by the former COO (2012 – \$68,754), which is non-interest bearing, unsecured and due on demand.
- (d) During the period ended December 31, 2013, the Company granted nil stock options to directors and officers and key employees and incurred director fees of \$17,484 to the directors of the Company (2012 – \$15,000). As at December 31, 2013, the Company owed \$32,119 to the independent directors (2012 – \$42,110), which is non-interest bearing, unsecured and due on demand.
- (e) During the period ended December 31, 2013, the Company accrued legal fees of \$13,375 to a company controlled by a former director of the Company. As at December 31, 2013, the Company had received invoices totaling \$44,255 from this company.
- (f) During the period ended December 31, 2013, the Company incurred accounting fees of \$33,333 to a company controlled by the former CFO of the Company (2012 – \$62,000). As at December 31, 2013, the Company owed \$nil to this company (2012 – \$66,200), which is non-interest bearing, unsecured and due on demand.

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16. RELATED PARTY TRANSACTIONS AND BALANCES (continued)

- (g) During the period ended December 31, 2013, the Company incurred salaries and wages expense of \$61,191 to relatives of former directors and officers of the Company (2012 – \$65,000). As at December 31, 2013, the Company owed \$nil to relatives of former directors of the Company (2012 - \$nil), which is non-interest bearing, unsecured and due on demand.
- (h) As at December 31, 2013, the Company owed \$106,793 to spouses of certain directors pursuant to a bridge loan agreement for an aggregate amount of \$100,000 entered on September 3, 2013. The total includes interest expense of \$6,793 related to the accretion of the discounted value of the loan.

These transactions were in the normal course of operations and have been recorded at their exchange amounts, which is the consideration agreed upon by the related parties.

17. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS

(a) Fair Values of Financial Instruments

The carrying values of cash and cash equivalents, restricted term deposits, bank indebtedness, accounts payable, and due to and from related parties are reasonable estimates of fair values due to the relatively short periods to maturity and the commercial terms of these instruments. The carrying values of long-term debt and finance lease obligations at December 31, 2013 are considered to be reasonable estimates of fair value based on current market rates for similar financial instruments.

(b) Fair Value Measurements

Certain of the Company's financial assets and liabilities are measured at fair value on a recurring basis and classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Certain non-financial assets and liabilities may also be measured at fair value on a non-recurring basis. There are three levels of the fair value hierarchy that prioritize the inputs to valuation techniques used to measure fair value, with Level 1 inputs having the highest priority. The levels and the valuation techniques used to value our financial assets and liabilities are described below:

Level 1 - Quoted Prices in Active Markets for Identical Assets

Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Cash equivalents, restricted term deposits and bank indebtedness, when applicable, are valued using quoted market prices. Accordingly, these items are included in Level 1 of the fair value hierarchy.

Level 2 - Significant Other Observable Inputs

Quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Derivative instruments are included in Level 2 of the fair value hierarchy as they are valued using pricing models or discounted cash flow models. These models require a variety of inputs, including, but not limited to, contractual terms, market prices, forward price curves, yield curves, and credit spreads. These inputs are obtained from or corroborated with the market where possible.

Level 3 - Significant Unobservable Inputs

Unobservable (supported by little or no market activity) prices.

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17. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS (continued)**(b) Fair Value Measurements (continued)**

Financial assets and liabilities measured at fair value on a recurring basis were presented on the Company's December 31, 2013 consolidated balance sheet as follows:

	Fair Value Measurements Using			
	Quoted Prices in Active Markets For Identical Instruments (Level 1) \$	Significant Other Observable Inputs (Level 2) \$	Significant Unobservable Inputs (Level 3) \$	Balance as Of December 31, 2013 \$
Assets:				
Cash and cash equivalents	244,923	—	—	244,923
Restricted term deposits	100,000	—	—	100,000

(c) Financial Risks**(i) Credit Risk**

Credit risk arises from the non-performance by counterparties of contractual financial obligations. The Company maintains substantially all of its cash and cash equivalents and term deposits classified as other assets in the balance sheet with major financial institutions. Deposits held with these institutions may exceed the amount of insurance provided on such deposits. As at December 31, 2013, the Company has significant accounts receivable from one major customer totaling \$310,848 (June 30, 2013 - \$379,715). The Company manages credit risk for trade and other receivables through established credit monitoring activities. As at December 31, 2013, the Company's maximum exposure to credit risk is the carrying value of cash and cash equivalents, accounts receivable, due from related parties and restricted term deposits.

The Company's concentration of, and past due, accounts receivable are summarized as follows:

	December 31, 2013		June 30, 2013	
	Over 90 days	Total	Over 90 days	Total
Provincial Liquor Boards	\$ 1,966	\$ 521,938	\$ 3,057	\$ 666,290
Total	\$ 1,966	\$ 521,938	\$ 3,057	\$ 666,290

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17. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS (continued)**(c) Financial Risks (continued)****(i) Credit Risk (continued)**

The Company has a concentration of credit risk because a majority of its accounts receivable are from provincial liquor boards, under provincially regulated industry sale and payment terms. The Company is not exposed to significant credit risk as payment in full is typically collected by provincial liquor boards at the time of sale and receivables are with government agencies. While substantially all of the Company's accounts receivable are from provincial government liquor authorities, the timing of receipts of large balances may vary significantly from period to period.

(ii) Liquidity Risk

Liquidity risk arises from the Company's general and capital financing needs. The Company continuously monitors and reviews both actual and forecasted cash flows, and also matches the maturity profile of financial assets and liabilities, when feasible.

Contractual undiscounted cash flow requirements for financial liabilities as at December 31, 2013 are as follows:

	Less Than 1 Year \$	Years 2 and 3 \$	Years 4 and 5 \$	More than 5 Years \$	Total \$
Accounts payable and accrued liabilities	1,098,550	–	–	–	1,098,550
Long-term debt (Note 9)	174,000	458,000	–	–	632,000
Finance lease obligations (Note 10)	22,706	75,760	–	–	98,466
	1,295,256	533,760	–	–	1,829,016

As at December 31, 2013, the Company had a positive working capital of \$106,134.

(iii) Interest Rate Price Risk

Certain of the Company's long-term debt instruments and finance lease obligations are subject to interest rate price risk as they carry fixed rates of interest. The Company's interest rate risk management policy is to purchase highly liquid investments with a term to maturity of three months or less on the date of purchase, when the instrument is not required as security for another financial obligation.

(iv) Interest Rate Cash Flow Risk

Certain of the Company's long-term debt instruments and bank indebtedness are subject to interest rate cash flow risk as they carry variable rates of interest. A plus or minus 1% change in market interest rates would not have a significant effect on the Company's loss and comprehensive loss for the year.

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18. COMMITMENTS AND CONTINGENCIES

- (a) The Company's future minimum operating lease payments for premises and vehicles for the next five years are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2014	\$ 180,069
2015	365,807
2016	342,964
2017	323,138
2018	323,138
	<u>\$ 1,535,116</u>

- (b) At December 31, 2013, the Company had issued a general excise bond of \$55,000 in favour of the Minister of National Revenue of Canada.
- (c) The Company has a bank operating line of credit with a limit of \$100,000 which bears interest at prime plus 1%, matures on October 31, 2015 and is extended automatically on a quarterly basis, and is secured by a term deposit of \$100,000 (see Note 7).

19. CAPITAL MANAGEMENT

The Company manages its capital structure in order to ensure sufficient resources are available to meet operational requirements. The Company is required to maintain term deposits of \$100,000 (June 30, 2013 - \$100,000) related to its bank line of credit (see Note 7). There are no other externally imposed capital requirements.

The Company seeks to manage capital to provide adequate funding for its operations while minimizing dilution for its existing shareholders. The Company's principal source of funds is from the issuance of common shares and warrants.

Management considers its long-term debt, finance lease obligations and shareholders' equity as capital, which consists of the following:

	<u>December 31, 2013</u>	<u>June 30, 2013</u>
Long-term debt (Note 9)	\$ 699,060	\$ 1,034,835
Finance lease obligations (Note 10)	81,677	100,460
Shareholders' equity	3,828,584	3,644,760
	<u>\$ 4,609,321</u>	<u>\$ 4,780,055</u>

20. MAJOR CUSTOMER

During the period ended December 31, 2013, the Company had sales of \$2,479,143 (December 31, 2012 - \$2,041,363) to the Manitoba Liquor Control Commission which accounted for 49% of its gross revenues (2012 - 47%).

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21. CONTINGENT LIABILITY

A claim was made against the Company from a company controlled by a former director of the Company in relation to legal services provided over the last two years and services provided pursuant to the Legal Service Agreement dated April 1, 2013 in the amount of \$62,961. In addition, severance of an amount equal to six months pursuant to the Legal Service Agreement was also considered in the claim. The claim may or may not proceed past the demand stage. If the claim does proceed, it will more than likely be settled.

22. SUBSEQUENT EVENTS

On January 20, 2014, the Company entered into a loan agreement with Weichun Ye, Yan Zeng and Dongbing (Derrick) Ma (Guarantor) for an aggregate principal amount of \$500,000 bearing interest at a rate of 9% per annum calculated and compounded semi-annually. The principal amount of the loan is due and payable on the earlier of December 31, 2015 and the occurrence of an event of default as defined in the loan agreement. The Company's obligations under the Loan Agreement are guaranteed by the Guarantor and, in consideration for acting as guarantor, the Company has granted to the Guarantor 4,000,000 non-transferable warrants, each warrants entitling the Guarantor to purchase one common share of the Company at an exercise price of \$0.05 per share until December 31, 2015.