

**RUSSELL BREWERIES INC.**  
**Management's Discussion and Analysis**  
**For the nine months ended March 31, 2014**

This Management's Discussion and Analysis ("MD&A") of Russell Breweries Inc. dated May 26, 2014 provides an analysis of Russell's results of operation and financial condition for the nine months ended March 31, 2014. This MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements, and accompanying notes for the nine months ended March 31, 2014 and with the audited consolidated financial statements and accompanying notes for the years ended June 30, 2013 and 2012. Additional information related to Russell Breweries Inc. is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.russellbeer.com](http://www.russellbeer.com).

The unaudited condensed consolidated interim financial statements and related notes of the Company have been prepared in accordance with the International Accounting Standards Board. All financial amounts in this MD&A are in Canadian dollars, except as otherwise indicated.

This MD&A was approved and authorized for issuance by the Board of Directors on May 26, 2014.

## **FORWARD LOOKING STATEMENTS**

*This report contains forward-looking information that is based on the Company's plans, intentions and expectations. By definition, forward-looking information involves risks, uncertainties and assumptions and is not a guarantee of future performance. Actual results could differ significantly from those anticipated, and hence investors should use caution when considering this information and not to put undue reliance on forward-looking statements.*

## **OVERVIEW**

Through its wholly-owned subsidiaries, Russell Brewing Company Ltd. located in Surrey, BC, and Fort Garry Brewing Company Ltd. located in Winnipeg, Manitoba. Russell Breweries Inc. ("the Company") operates two craft breweries producing premium quality beers for pubs, restaurants and liquor stores. The Company acquired Fort Garry Brewing Company Ltd. ("Fort Garry") on October 22, 2007. Fort Garry is Manitoba's oldest and largest brewer and distributor of premium quality beers. The Company's operations include production facilities in Surrey, BC and Winnipeg, Manitoba, corporate offices in Surrey, BC, storage facilities, brewing equipment, and delivery and sales vehicles. Both breweries produce a variety of limited and seasonal products in addition to their main product lines including: Russell Cream Ale, Russell Pale Ale, Russell Honey Blonde Ale, Russell Extra Special Lager, Russell IP'eh! India Pale Ale, A Wee Angry Scotch Ale, Blood Alley Bitter, Russell Lemon Ale, Rocky Mountain Pilsner, Fort Garry Dark Ale, Fort Garry Pale Ale, Fort Garry Premium Light, Fort Garry Red and Stone Cold Lager.

## **BUSINESS DEVELOPMENTS AND SIGNIFICANT EVENTS**

On July 10, 2012, the Company celebrated its 17th Anniversary with a limited edition barrel aged Scotch Ale. This strong, dark ale was brewed with Scottish specialty peated malts for a slightly smoky character, and then skillfully aged in Bourbon barrels. This special Anniversary Ale was crafted by our team of brewers to thank everyone for enjoying our unique beers throughout the years.

On July 13, 2012, the Company announced that it agreed to terms under a letter of intent for the initial non-exclusive rights to import, produce, package, use, market, sell and distribute Russell brands and branded merchandise with FVI Capital Inc. ("FVI") in China. The letter specifies the principal terms of a technology and trade mark license agreement ("Agreement") which includes an initial up-front licensing fee, to be paid by a new Company ("Licensee") being established by FVI to hold the license and ongoing royalties based on volume of beer produced up to 50,000 hectoliters. The Company will take an initial 20% equity position in Licensee. As part of the agreement, the Licensee has a 48 month first matching option

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to acquire an exclusive license for the entire Chinese market for an additional license fee payment and ongoing per hectoliter royalty payments and the Company has an option to increase its stake in the Licensee to 25% at Fair Market Value within the same 48 month term.

On July 26, 2012, the Company released its Blood Alley Bitter in 6 pack 341ml bottles.

On July 27, 2012, the Company announced that it agreed to a one year extension and amendment to a loan agreement dated December 31, 2007, pursuant to which the lender, a shareholder of Russell, had provided to the Company a loan valued at maturity in the amount of \$1,239,000. (see LIQUIDITY AND CAPITAL RESOURCES)

On September 21, 2012, the Company released 'Russell Marzen', a seasonal limited release as part of the Russell Brewmaster Series.

On October 9, 2012, the Company completed a non-exclusive technology and trade mark license agreement ("Agreement") with Russell Breweries (China) Inc. to import, produce, package, use, market, sell and distribute Russell brands in China, including Hong Kong and Taiwan. The principal terms of the Agreement includes use of name for the new company, an initial up-front licensing fee and ongoing royalties based on volume of beer produced and sold. In addition, the Company will subscribe for a 20% equity position in Licensee with an option to increase its position to 25%.

On October 10, 2012, the Company released the next batch of the super-premium, single-batch beer - Nectar of the Gods Wheat Wine Ale. The entire batch was pre-sold to select private liquor stores in metro Vancouver.

On November 15, 2012, the Company released 'Happy Jack Pumpkin Ale', a limited-edition seasonal beer as part of the Fort Garry Brewmaster Series.

On November 22, 2012, Mr. Paul Robertson resigned as a Director of the Company. On November 26, 2012, Mr. Perpinder Singh Patola was appointed to the Board of Directors and Mr. Robert Murray and Mr. Richard Shier resigned as Directors.

On November 23, 2012, the Company released 'Russell IP'eh! India Pale Ale' in 6 pack 341ml bottles.

On November 24, 2012, the Company released 'Hop Therapy Double IPA', a new single-batch brew as part of the Russell Brewmaster Series.

On November 26th, 2012, the Company released 'Naughty & Spiced Porter', a limited-edition seasonal beer as part of the Russell Brewmaster Series. The Company also released 'St Nick's Porter', a limited-edition seasonal beer as part of the Fort Garry Brewmaster Series.

On March 18, 2013, the Company announced non-brokered private placement for gross proceeds of up to \$1,000,000 in the form of equity units consisting of common shares and warrants to purchase common shares of the Company. On May 17, 2013, the Company completed the financing with gross proceeds totaling \$482,000 (see LIQUIDITY AND CAPITAL RESOURCES: Financing).

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On March 31, 2013, the Company exercised its right, pursuant to an exchange agreement dated March 31, 2008 between the Company and the holders (the "Investors") of Class A Exchangeable Non-Voting Preferred Shares (the "Exchangeable Shares") in the capital of the Company's subsidiary, to purchase the exchangeable shares from the Investors. Each Exchangeable Share was exchanged for a total of 22.67 common shares (the "Common Shares") in the capital of the Company. The Company issued, as fully paid and non-assessable shares of the Company, an aggregate of 1,541,560 Common Shares to the Investors, in order to purchase an aggregate of 68,000 Exchangeable Shares held by the Investors and to settle the \$204,000 unpaid dividend amount as well as the maximum penalty for not paying all cumulative dividends due and payable as of March 31, 2011 (see LIQUIDITY AND CAPITAL RESOURCES: Financing).

Further to the agreement signed with FVI Capital Inc. in October 2012, the Company announced, on May 2, 2013, that a test brewery and brewpub restaurant was scheduled to open this summer in Hefei, the largest city of Anhui Province of Eastern China with a population of 5.7 million.

On May 14th, 2013, the Company's wholly owned subsidiary, Russell Brewing Company Ltd., was honoured with two distinctions at 2013 Canadian Brewing Awards (CBA) in Victoria, BC. The Company took bronze for 'Black Death Porter' in the Porter category and bronze for 'Hop Therapy Double IPA' in the Imperial India Pale Ale category.

On May 15, 2013, Mr. Derrick Ma and Mr. Benjamin Yu were appointed to the board of directors. On June 27, 2013, Mr. Andrew Harris, resigned as President and Chief Operating Officer. On July 10, 2013, Mr. Gary Liu resigned as Chief Financial Officer and director of the Company. On July 29, 2013, Mr. Perpinder Singh Patrola resigned as a director of the Company.

On July 31, 2013, the Company repaid \$206,834 of a loan entered on July 11, 2012, with a shareholder of the Company in the amount of \$836,834 due on July 31, 2013, and negotiated to further amend and extend repayment of the balance of \$650,000 over 36 months (see LIQUIDITY AND CAPITAL RESOURCES: Financing).

On August 9, 2013, Mr. Peter H. Stafford and Mr. Richard Ruijian Shi were appointed to the board of directors of the Company. Effective September 1, 2013, Mr. Brian Harris retired as Chief Executive Officer ("CEO") of the Company. Mr. Benjamin Li Yu will act as interim CEO until a suitable and permanent replacement is found.

On September 3, 2013, the Company entered into a bridge loan agreement with the spouses of certain directors of the Company (collectively, the "Lenders") whereby the Lenders will provide the Company with a loan facility in the aggregate amount of CDN\$100,000. (see LIQUIDITY AND CAPITAL RESOURCES: Financing).

On October 2, 2013, the Company reported that its partners in China (Russell Breweries Inc. China "RBIC") completed construction on a new test brewery in Hefei, China. The brewery is now fully operational and its adjoining restaurant will be opened for business soon.

On October 24, 2013, Mr. Kwong Choo was appointed as Chief Financial Officer of the Company.

On January 22, 2014, the Company entered into a loan agreement with Weichun Ye and Yan Zeng (the Lenders) and Dongbing (Derrick) Ma (the Guarantor), whereby the Lenders will loan to the Company an aggregate principal amount of \$500,000.

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On May 7, 2014, the Company announced that it has completed the first tranche of its non-brokered private placement of common shares of the Company as previously announced on Mar 20, 2014 of up to \$500,000 at the price of \$0.06 per Share. Under the private placement, the Company issued and sold 7,083,333 shares for aggregate gross proceeds of \$424,999.98.

Currently, the Company's products are segmented into the following categories:

Categories	Brands
Super Premium	Russell Nectar of the Gods Wheat Wine Ale, Fort Garry Kona Imperial Stout, Russell Hop Therapy Double IPA, Truth Serum Wheat Wine
Premium:	Eastern Promises, Russell IP'EH!, Black Death Porter, Russell Marzen, A Wee Angry Scotch Ale, Blood Alley Bitter, Fort Garry Munich Eisbock, Portage and Main IPA
Session:	Russell Cream Ale, Russell Pale Ale, Russell Honey Blonde Ale, Russell Extra Special Lager, Fort Garry Dark, Fort Garry Pale, Fort Garry Rouge, Fort Garry Light, Citrus Twist, Craft Collection
Value:	Rocky Mountain Pilsner, Stone Cold Lager, Two Rivers
Seasonal:	Russell Lemon Ale, Russell Lime Lager, Russell Naughty & Spiced Porter, Russell Rick August Russian Imperial Stout, Smokey The Beer, Nectar of the Gods
Partnership:	Chambar Ale, Main Street Pilsner, GUUU Ale, Bayside Shark Lager, Cactus Double Down Draught, The Big Smoke

**SELECTED INFORMATION**

The following table summarizes certain financial information of the Company for the periods indicated below:

Selected Information	Nine Months Ended March 31, 2014	Nine Months Ended March 31, 2013	Nine Months Ended March 31, 2012
	\$	\$	\$
<b>Statement of Comprehensive Loss Data</b>			
Gross Revenues	7,063,571	6,228,321	6,064,116
Net Revenues (after excise tax and provincial mark-up)	5,565,663	4,857,006	4,665,014
Earnings before interest and other income, taxes, depreciation and amortization (EBITDA)	663,277	450,466	3,266
Total income (loss) from continuing operations	248,263	(77,505)	(610,724)
Operating income (loss) per share	0.00	(0.00)	(0.00)
Net income (loss) and comprehensive income (loss)	248,263	(77,505)	(610,724)
Basic and diluted earnings (loss) per share	0.00	(0.00)	(0.00)
<b>Statement of Financial Position Data</b>			
Total assets	6,924,195	6,723,030	7,208,363
Total long term financial liabilities	764,246	187,823	283,441
Cash dividends declared per share	Nil	Nil	Nil

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**PERFORMANCE AND RESULTS OF OPERATIONS**

***Three Months Ended March 31, 2014 ("Q3 2014F")***

The Company had a net income of \$62,648 for Q3 2014F compared to the net income of \$73,595 for the three months ended March 31, 2013 ("Q3 2013F"). The decrease in net income is primarily due to a decrease in gross margin of \$38,138 and increase in other expenses of \$21,078, which is offset by a decrease in amortization of \$9,350 and selling, general and administrative expenses of \$38,918.

Gross revenues for Q3 2014F were \$2,048,897 up \$130,204 or 7% compared to \$1,918,693 for Q3 2013F. Net revenue for Q3 2014F were \$1,653,603 up \$113,916 or 7% compared to \$1,539,687 for Q3 2013F. The increase is mainly due to increased pricing and volumes from additional sales personnel hired to service wider geographical area.

The gross margin for Q3 2014F reduced by \$38,138 or 4% to \$912,928 compared to \$951,065 for Q3 2013F. The gross margin percentage of Q3 2014F was down 7% to 55% compared to 62% for Q3 2013F. The decrease in gross margin percentage is mainly due to higher cost of raw materials and packaging materials.

Selling, general and administration expenses for Q3 2014F were \$783,614 down \$38,918 or 5% compared to \$822,532 for Q3 2013F. This is primarily due to the following reasons:

- (i) Labour cost increased by \$63,414 to \$264,241 from \$200,827 due to severance payment, higher headcount in sales and annual salary increases.
- (ii) Bad debts increased by \$24,678 to due to the write off of uncollectable accounts for this period.
- (iii) Advertising and promotion increased by \$19,438 from \$184,517 to \$165,079 due to higher marketing and promotional spending to support new products.

Offset by the following:

- (i) Professional fees decreased by \$73,044 to \$54,002 from \$127,046 mainly due to lower accounting fees as a result of the resignation of the previous CFO.
- (ii) Management fees decreased by \$47,803 to \$23,792 from \$71,595 due to the retirement and resignation of the previous CEO and COO.

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***Nine Months Ended March 31, 2014 ("Q3 2014F" and "2014F YTD")***

The Company had a net income of \$248,263 for Q3 2014F compared to the net loss of \$77,505 for the nine months ended March 31, 2013 ("2013F YTD"). The increase in net income is primarily due to an increase in gross margin of \$368,810, which is offset by increase in selling, general and administrative expenses of \$151,483 and decrease in other expenses of \$72,263.

Gross revenue for 2014F YTD were \$7,063,571 up \$835,250 or 13% compared to \$6,228,321 for 2013F YTD. Net revenue for 2014F YTD were \$5,565,663 up \$708,657 or 15% compared to \$4,857,006 for 2013F YTD. The increase is mainly due to increased pricing and volumes, optimized product mix and the addition of sales personnel to service wider geographical area.

The gross margin for 2014F YTD increased by \$368,810 or 13% to \$3,166,326 compared to \$2,797,516 for 2013F YTD. The gross margin percentage of 2014F YTD was down 1% to 57% compared to 58% for 2013F YTD. The decrease is mainly due to the higher cost of raw materials and packaging materials.

Selling, general and administration expenses for 2014F YTD were \$2,738,568 up \$151,483 or 6% compared to \$2,587,085 for 2013F YTD. This is primarily due to the following reasons:

- (i) Labour cost increased by \$186,351 from \$641,736 to \$828,087 due to severance payment, higher headcount in sales and annual salary increases.
- (ii) Advertising and promotion increased by \$53,093 from \$574,597 to \$627,690 due to higher marketing and promotional spending to support new products.
- (iii) Refundable container increased by \$33,366 from negative \$21,592 to positive \$11,774 due to seasonal fluctuations on returning containers.
- (iv) Bad debts increased by \$24,678 due to the write off of uncollectable accounts.

Offset by the following:

- (i) Management fees decreased by \$129,392 from \$216,000 to \$86,608 due to the retirement and resignation of the previous CEO and COO.
- (ii) Stock based compensation expense decreased by \$39,317 from \$38,124 to a negative \$1,193.

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**Summary of Quarterly Results**

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

<b>Fiscal Year Quarter</b>	<b>2014F Q3</b>	<b>2014F Q2</b>	<b>2014F Q1</b>	<b>2013F Q4</b>	<b>2013F Q3</b>	<b>2013F Q2</b>	<b>2013F Q1</b>	<b>2012F Q4</b>
(in \$000, except per share amounts)								<i>Restated</i>
	\$	\$	\$	\$	\$	\$	\$	\$
Net revenues	1,654	1,972	1,940	1,875	1,540	1,511	1,807	1,813
SG&A <sup>(1)</sup>	784	960	995	1,005	823	910	855	1,056
EBITDA <sup>(2)</sup>	213	211	239	(136)	220	82	148	30
Net income (loss)	63	92	94	(468)	74	(88)	(63)	(477)
Net earnings (loss) per share	0.00	0.00	0.00	(0.01)	0.00	(0.00)	(0.00)	(0.01)

(1) SG&A represents Selling, General and Administrative expenses.

(2) EBITDA represents earnings before interest, income taxes, depreciation and amortization. EBITDA is a non-IFRS earnings measure, therefore it does not have any standardized meaning prescribed by International Financial Reporting Standards and may not be similar to measures presented by other companies. Management uses this measurement to evaluate the operating results of the Company.

The Company has historically experienced a seasonal pattern in its operating results, with the second and third quarters historically exhibiting lower revenues. Net revenue for Q3 2014F were \$1,653,603 down by \$317,987 compared to \$1,971,590 for Q2 2014F. Net income for Q3 2014F was \$62,648 down by \$29,235 compared to net income of \$91,883 for Q2 2014F. The decrease in net revenue is mainly due to seasonality and fluctuation in gross margin.

The results in any one quarter are not indicative of results in any other quarter, or for the year as a whole.

**LIQUIDITY AND CAPITAL RESOURCES**

**Financial Condition**

At March 31, 2014, the Company had a positive working capital of \$751,504. The Company has \$514,522 of cash and \$100,000 of restricted term deposits securing \$100,000 of bank indebtedness. Liabilities include \$829,617 of accounts payable and accrued liabilities, \$1,118,594 of long-term debts (Note 9 of the interim financial statements), and \$71,826 of finance lease obligations (Note 10 of the interim financial statements).

The Company has an operating line of credit, a bridge loan, four finance leases, two operating leases and three term loans. As at March 31, 2014 and the date of this MD&A, the Company is in compliance with all of the covenants.

The Company will need additional capital to fund its planned non-discretionary capital expenditures for the next twelve months. There is no guarantee that the Company will be able to raise additional equity or debt financing on favorable terms if at all or generate cash flow from operations in the future.

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**Cash Flow**

***Nine Months Ended March 31, 2014 ("2014F YTD")***

Cash provided by operating activities in 2014F YTD was \$206,910 compared to \$361,941 in 2013F YTD. The decreased in cash provided of \$155,031 was primarily due to the decrease in due to and from related parties, changes in inventories and the increase in cash used for accounts payable and accrued liabilities.

Cash used in 2014F YTD for investing activities was \$29,092 for purchase of property and equipment compared to the purchase of property and equipment of \$28,169 in 2013F YTD.

During 2014F YTD, the Company received \$100,000 from bridge loan and \$500,000 from private placement, repayment of \$430,843 in long-term debts, \$36,671 in bank indebtedness and \$28,634 in finance lease obligations compared to repayment of \$103,500 in long-term debt, \$35,793 in bank indebtedness and \$39,738 in finance lease obligations in 2013F YTD.

**Outstanding Share Data**

As at March 31, 2014, the Company had 78,750,455 common shares issued and outstanding. In addition, the Company had the following outstanding share data at the date of this MD&A:

<b>Outstanding Share Data</b>	<b>Number of Common Shares</b>	<b>Exercise Price per Common Share</b>	<b>Expiry Dates</b>
Issued and outstanding as at March 31, 2014	78,750,455	N/A	N/A
Stock options <sup>(1)</sup>	50,000	\$0.10	March 9, 2017
Warrants	9,640,000	\$0.10	May 17, 2015
Warrants	<u>4,000,000</u>	\$0.05	December 31, 2015
Fully Diluted as at March 31, 2014	<u>92,440,455</u>	N/A	N/A

(1) For the first nine months ended March 31, 2014, 1,250,000 stock options exercisable at \$0.10 per share were forfeited due to the resignation of certain directors, officers, and employees.

**Financing**

- (a) On October 5, 2010, the Company's subsidiary Fort Garry Brewing Company Ltd. accepted an offer of \$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%, repayable in monthly installments of \$1,750, 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 is allowed to issue 250,000 common shares of the Company as bonus shares for a deemed value of \$0.08 per share for a total value of \$20,000, which was recorded as a discount against the value allocated to the loan. During the nine months ended March 31, 2014, the Company repaid \$15,750 plus interest of \$1,955.

The Company also recorded interest expense of \$1,728 (March 31, 2013 - \$3,591) 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. As at March 31, 2014, the outstanding balance of the loan is \$22,929 (Note 9 of the interim financial statement).



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The Company also has a term bank loan with BDC, bearing interest at a floating base rate plus a variance of 1%, repayable in monthly installments of \$9,750 plus interest maturing November 15, 2014, secured by the assets of Fort Garry. During the nine months ended March 31, 2014, the Company repaid \$87,750 plus interest of \$5,926. As at March 31, 2014, the outstanding balance of the loan is \$82,609 (Note 9 of the interim financial statement).

- (b) On July 11, 2012, the Company agreed to an one year extension (the "Extension") and amendment to a loan agreement (the "Loan Agreement") dated December 31, 2007, pursuant to which the lender ("Lender"), a shareholder of the Company, had provided to the Company a loan (the "Loan") valued at maturity in the amount of \$1,239,000.

The Extension is for one year, with \$812,460 due on maturity on July 31, 2013. The Company negotiated a discounted value or loan advance amount (the "Loan Advance Amount") of \$738,600, that is calculated based on a 10% per annum interest rate, calculated semi-annually, with interest payable on maturity, resulting in a total loan value of \$812,460 at maturity. 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 Loan 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 capital lease obligations incurred for future acquisitions of equipment and other capital assets.

During the nine months ended March 31, 2014, the Company recorded interest expense of \$8,608 (March 31, 2013 - \$56,121) 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.

On July 31, 2013, the Company repaid \$206,833.80 of a loan (the "Loan") entered into on July 11, 2012, with a shareholder of the Company (the "Lender") in the amount of \$836,833.80 due on July 31, 2013, and negotiated to further amend and extend repayment of the balance of \$650,000 (the "Loan Amount") as follows: a 10% per annum interest rate, calculated semi-annually, repayable in monthly installment of \$17,500 plus interest maturing July 31, 2016. In consideration of the Lender agreeing to amend and extend the Loan, the Lender will also earn a bonus of \$20,000 to be included in the Loan Amount, subject to penalty of \$17,500 for each missed monthly installment payment.

The Loan is guaranteed by Russell Brewing Company Ltd. and Fort Garry Brewing Company Ltd., both wholly-owned subsidiaries of the Company. As further security for the Loan, the Company and its Canadian subsidiaries 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. The Company may repay the Loan at any time without penalty by paying the discounted Loan Amount outstanding together with accrued interest and prorated bonus.

- (c) During the year ended June 30, 2011, the Company completed, in three tranches, a private placement of units (the "Unit Offering") and a private placement of convertible debentures (the "Debenture Offering") (together, the "Offerings"). Under the Unit Offering, the Company issued 12,730,000 units (the "Units"), at a price of \$0.08 per Unit, for aggregate gross proceeds of \$1,018,400. Each Unit is comprised of one common share and one common share purchase

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warrant (a "Warrant"). Each Warrant is exercisable for two years after the issuance of the Units to acquire one common share at an exercise price of \$0.15 per common share. Under the Debenture Offering, the Company issued convertible debentures (the "Convertible Debentures") in the aggregate principal amount of \$740,750. The Convertible Debentures are convertible into common shares at a price of \$0.15 per common share for a two-year period from the date of issue. The Convertible Debentures bear interest at 10% per annum, payable quarterly in arrears.

Canaccord Genuity Corp. ("Canaccord") acted as agent for the Offerings and as consideration for its services received a cash commission equal to 10% of the gross proceeds from the Offerings and 2,120,200 warrants (the "Agent's Warrants") equal to 12% of the number of Units and 12% of the number of common shares underlying the Convertible Debentures sold pursuant to the Offerings. Each Agent's Warrant entitles the holder, on exercise, to acquire one unit on the same terms as the Units for a price of \$0.08 per unit for a period of 24 months from date of issue. The Company also issued 625,000 common shares with a fair value of \$56,250 to the Agent as a corporate finance fee. Other share issue costs were \$96,607.

During the year ended June 30, 2013, the Company redeemed its convertible debentures maturing on November 4, 2012, December 3, 2012 and December 24, 2012. The aggregate principal amount of the convertible debentures outstanding was \$740,750. On the redemption dates, the Company redeemed the whole of the principal amount of the convertible debentures by issuing a total of 4,938,333 fully paid and non-assessable common shares in the capital of the Company, at a price equal to \$0.15 per common share.

- (d) On January 20, 2012, the Company closed a non-brokered private placement (the "Private Placement"). Under the Private Placement, the Company issued 15,300,000 units (the "Units") at a purchase price of \$0.05 per Unit, for aggregate gross proceeds of \$765,000. Each Unit is comprised of one common share ("Common Share") in the capital of the Company, and one half of one non-transferable share purchase warrant ("Warrant"). Each whole Warrant entitles the holder to purchase one additional Common Share at a price of \$0.10 for a period of one year from closing the Private Placement. The term of the Warrants is subject to an acceleration right at the option of the Company, provided that the daily volume-weighted average trading price of the Common Shares is \$0.15 or higher for at least 10 consecutive trading days and the Company has provided Warrant holders with 30 days prior written notice of the accelerated exercise date. The Company has paid finder's fees totaling \$35,000 and share issue cost totaling \$14,140 in connection with the Private Placement in accordance with the policies of the TSX Venture Exchange.
- (e) On March 31, 2013, the Company, pursuant to an exchange agreement (the "Exchange Agreement") dated for reference as of March 31, 2008, between the Company, Russell Brewing Company Ltd. ("Subco"), and holders (the "Investors") of Class A Exchangeable Non-Voting Preferred Shares (the "Exchangeable Shares") in the capital of Subco, the Company exercised its right (the "Exchange Right") to purchase the Exchangeable Shares from the Investors. The Company is entitled to exercise the Exchange Right and purchase the Exchangeable Shares without any further action required on the part of the Investors.

As per the exchange ratio stipulated in the Exchange Agreement, each Exchangeable Share is exchangeable for 22.67 common shares (the "Common Shares") in the capital of the Company. The Company has issued, as fully paid and non-assessable shares of the Company, an aggregate of 1,541,560 Common Shares to the Investors, in order to purchase an aggregate of 68,000 Exchangeable Shares held by the Investors (the "Exchange"). Certificates registered in the names of the Investors, representing the aggregate number of Common Shares deliverable by the Company in payment for the Exchangeable Shares, have been couriered to the Investors.

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The 68,000 Exchangeable Shares were issued to Investors pursuant to a brokered private placement (the "Private Placement") announced on March 5th, 2008, at a price of \$10.00 per Exchangeable Share, for gross proceeds of \$680,000. The Private Placement was offered in connection with the Province of British Columbia's Equity Capital Program (the "Program"). Residents of British Columbia investing in a company registered under the Program were eligible for a tax credit of up to 30% of their investment.

- (f) On May 17, 2013, the Company closed a non-brokered private placement (the "Private Placement") of units announced previously on March 18, 2013. Under the Private Placement, the Company issued 9,640,000 units (the "Units") at a purchase price of \$0.05 per Unit, for aggregate gross proceeds of \$482,000.00. Each Unit is comprised of one common share ("Common Share") in the capital of the Company, and one non-transferable share purchase warrant ("Warrant"). Each Warrant entitles the holder to purchase one additional Common Share at a price of \$0.10 for a period of two years from closing the Private Placement. The term of the Warrants is subject to an acceleration right at the option of the Company, provided that the daily volume-weighted average trading price of the Common Shares is \$0.15 or higher for at least 10 consecutive trading days and the Company has provided Warrant holders with 30 days prior written notice of the accelerated exercise date.

The securities issued pursuant to the Private Placement will be subject to a hold period of four months and one day from the date of issue in compliance with applicable securities laws and the rules of the TSX Venture Exchange. The net proceeds from the Private Placement will be used for general working capital requirements. Certain directors and officers of the Company have acquired Units under the Private Placement. Any such participation is considered to be a "related party transaction" as defined under Multilateral Instrument 61-101 ("MI 61-101"). The transaction is exempt from the formal valuation and minority shareholder approval requirements of MI 61-101 as neither the fair market value of any Units issued to, nor the consideration paid by, such persons exceeds 25% of the Company's market capitalization.

- (g) On September 3, 2013, the Company entered into a bridge loan agreement (the "Bridge Loan Agreement") with the spouses of certain directors of the Company (collectively, the "Lenders") whereby the Lenders will provide the Company with a loan facility in the aggregate amount of CDN\$100,000 (the "Bridge Loan"). The Bridge Loan will bear interest at a rate of 9.0% per annum calculated and compounded semi-annually. The term of the Bridge Loan will be one year from the date of the Bridge Loan Agreement and the principal and accrued interest shall be due and payable on the earlier of:

(i) the expiry of the term of the Bridge Loan, or (ii) the occurrence of an event of default in the Bridge Loan Agreement. The Bridge Loan may be prepaid, at any time, without premium or penalty.

Pursuant to the terms of the Bridge Loan Agreement, the Company intends issue and allot to each of the Lenders such number of common shares (the "Bonus Shares") in the capital of the Company equivalent to 20% of the dollar amount of each Bridge Loan which shall be priced, when issued and allotted, in accordance with the policies of the TSX Venture Exchange. The Bonus Shares are to be issued and allotted to compensate the Lenders for the financial risk associated with granting the Bridge Loan to the Company.

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Pursuant to the terms of the Bridge Loan Agreement, the Company and its Canadian subsidiaries have each executed a security agreement in favour of the Lenders, granting security interests in all present and future undertaking and property of the Company and each Canadian subsidiary, as applicable. The proceeds of the Loan will be used for general working capital.

The Company also recorded interest expense of \$12,173 (March 31, 2013 - \$nil) 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.

- (h) 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.
- (i) On May 7, 2014, the Company completed the first tranche of its non-brokered private placement of common shares of the Company as previously announced on March 20, 2014. Under the private placement, the Company issued and sold 7,083,333 shares for aggregate gross proceeds of \$424,999.98. The shares issued pursuant to the private placement are subject to a hold period of four months and one day from the closing date. On the basis that one of the subscribers of the Private Placement, Benjamin Li Yu, is a director and interim CEO of the Company, the sale and issuance of 1,666,666 shares to Mr. Yu is a "related party transaction" within the meaning of Multilateral Instrument 61-101.

**Contractual Obligations, Commitments**

The Company utilizes operating leases to finance manufacturing equipment and vehicles. The Company also leases the building in Surrey, BC and Winnipeg, Manitoba where it has its warehousing and packaging operations. By entering into operating leases, the Company is able to update its equipment more frequently, not utilize its cash to invest in these assets and in so doing lower its overall average cost compared with purchasing the assets. All leases are evaluated at inception for appropriate accounting treatment.

A summary of the Company's contractual obligations for the next five years are as follows (Note 17 (c) (ii) of the interim financial statement):

	Less Than 1 Year	Years 2 and 3	Years 4 and 5	More Than 5 Years	Total
	\$	\$	\$	\$	\$
Accounts payable and accrued liabilities	829,617	—	—	—	829,617
Long-term debt	87,000	958,000	—	—	1,045,000
Finance lease obligations	9,300	75,760	—	—	85,060
	<b>925,917</b>	<b>1,033,760</b>	<b>—</b>	<b>—</b>	<b>1,959,677</b>

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**RELATED PARTIES**

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:

	<b>Nine Months Ended March 31, 2014</b>	Nine Months Ended March 31, 2013
Management and consulting fees (Notes 16(a), (b) & (c))	<b>\$ 193,108</b>	\$ 216,000
Directors fees (Note 16(d))	<b>26,484</b>	15,000
Accounting fees	<b>42,293</b>	93,000
Share-based payments	<b>(1,193)</b>	38,124
	<b>\$ 260,692</b>	\$ 362,124

- (a) During the period ended March 31, 2014, the Company incurred management fees of \$nil to the CEO of the Company (2013 – \$nil) and \$58,333 to a company controlled by the CEO (2013 – \$nil). As at March 31, 2014, the Company owed \$36,000 to the CEO and a company controlled by the CEO (2013 – \$nil), which is non-interest bearing, unsecured and due on demand.
- (b) During the period ended March 31, 2014, the Company incurred management and consulting fees of \$nil to the former CEO of the Company (2013 – \$nil) and \$128,000 to a company controlled by the former CEO (2013 – \$108,000). As at March 31, 2014, the Company owed \$nil to the former CEO and a company controlled by the former CEO (2013 – \$63,560), which is non-interest bearing, unsecured and due on demand.
- (c) During the period ended March 31, 2014, the Company incurred management fees of \$nil to the former COO of the Company (2013 – \$nil) and \$6,774 to a company controlled by the former COO (2013 – \$108,000). As at March 31, 2014, the Company owed \$nil to the former COO and a company controlled by the former COO (2013 – \$63,555), which is non-interest bearing, unsecured and due on demand.
- (d) During the period ended March 31, 2014, the Company granted nil stock options to directors and officers and key employees and incurred director fees of \$26,484 to the directors of the Company (2013 – \$15,000). As at March 31, 2014, the Company owed \$9,000 to the independent directors (2013 – \$42,110), which is non-interest bearing, unsecured and due on demand.
- (e) During the period ended March 31, 2014, the Company accrued legal fees of \$13,375 (2013 – \$62,188) to a company controlled by a former director of the Company. As at March 31, 2014, the Company had received invoices totaling \$44,255 from this company.
- (f) During the period ended March 31, 2014, the Company incurred accounting fees of \$33,333 to a company controlled by the former CFO of the Company (2013 – \$93,000). As at March 31, 2014, the Company owed \$nil to this company (2013 – \$87,880), which is non-interest bearing, unsecured and due on demand.

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- (g) During the period ended March 31, 2014, the Company incurred salaries and wages expense of \$61,191 to relatives of former directors and officers of the Company (2013 – \$107,411). As at March 31, 2014, the Company owed \$nil to relatives of former directors of the Company (2013 - \$nil), which is non-interest bearing, unsecured and due on demand.
- (h) As at March 31, 2014, the Company owed \$112,173 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 \$12,173 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.

**CRITICAL ACCOUNTING ESTIMATES**

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of 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.

**Property, Plant and Equipment**

The accounting for property, plant and equipment requires that management make estimates involving the life of the assets, the selection of an appropriate method of depreciation and determining whether an impairment of assets exists.

The Company reviews the residual values, useful lives of depreciable assets and depreciation method on an annual basis and where revisions were made; the Company applies such changes in estimates on a prospective basis.

The net carrying amounts of property, plant and equipment are reviewed for impairment either individually or at the cash generating unit level at the end of each reporting period. If there are indicators of impairment, an evaluation is undertaken to determine whether the carrying amounts are in excess of their recoverable amounts. An asset's recoverable amount is determined as the higher of its fair value less cost to sell and its value-in-use. To the extent that an asset's carrying amount exceeds its recoverable amount, the excess is fully provided for in the period in which it is determined to be impaired. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior periods.

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There is uncertainty in these estimates as the related recoverable amounts are projected for future years based on underlying assumptions such as volume growth, inflation factors and industry trends which may not materialize. Management uses its best estimates to forecast these amounts, but the actual amounts may vary from estimates. Should future results differ from management's estimates, an impairment of these assets and a related write-down may result. As at the date of this report, the Company believes that its estimates are materially correct.

**Intangible Assets**

Indefinite life intangible assets consist of brands and trademarks. These assets are recorded at cost and are not amortized but instead are reviewed for impairment at the end of each reporting period. If there are indicators of impairment, an evaluation is undertaken to determine whether the carrying amounts are in excess of their recoverable amounts. An asset's recoverable amount is determined as the higher of its fair value less cost to sell and its value-in-use. There is uncertainty in these estimates as the related recoverable amounts are projected for future years based on underlying assumptions such as volume growth, inflation factors and industry trends which may not materialize. Management uses its best estimates to forecast these amounts, but the actual amounts may vary from estimates. Should future results differ from management's estimates, an impairment of these assets and a related write-down may result. As at the date of this report, the Company believes that its estimates are materially correct.

**RISKS AND UNCERTAINTIES**

**Credit Risk**

The Company grants credit to its customers in the normal course of business. However as the major portion of the accounts receivable are held by the BC Liquor Distribution Board (BCLDB), the Manitoba Liquor Control Commission (MLCC) and Alberta Gaming and Liquor Commission (AGLC), management believes exposure to credit risk is limited.

**Competition**

The Company considers its main competitors to be other participants in the Canadian brewing industry, which includes imported beer and specialty and value priced brands brewed by both small regional brewers and the national brewers. Existing regional breweries are increasing their production capacities and marketing programs. National brewers are aggressively promoting their own specialty and value brands as well as premium brands. The Company also anticipates increasing competition as new brewers enter markets in which the Company currently operates.

The principal competitive factors affecting the market for the Company's products include quality and taste, packaging, advertising and promotional support, brand recognition and price. There can be no assurance that the Company will be able to compete successfully in this category against current and future competitors based on these and other factors. The Company competes with a variety of domestic and international brewers, many of whom have substantially greater financial, production, distribution and marketing resources. The Company anticipates increased competition in the premium beer category from the major domestic brewers, each of whom has introduced and is marketing premium-priced products. The large domestic brewers dominate the domestic beer market and the Company expects that certain of these companies may seek further participation in the premium beer market through the acquisition of equity positions in, or the formation of, distribution alliances with other brewers.

Increased competition could result in price reductions, reduced profit margins and loss of market share, all of which could have a material adverse effect on the Company's operations. The Company's products also compete generally with other alcoholic beverages.

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**Government Regulation**

The Company's business is regulated by federal, provincial and municipal laws and regulations regarding such matters as licensing requirements, trade and pricing practices, permitted and required labeling, advertising, promotion and marketing practices, relationships with distributors and related matters. Failure on the part of the Company to comply with federal, provincial or municipal laws and regulations could result in the loss, revocation or suspension of the Company's licenses, permits or approvals and could have a material adverse effect on the Company's business. The Company believes that it has obtained all regulatory permits and licenses necessary to operate its business where the Company's products are currently being produced and distributed. In addition, changes to taxes, environmental regulations or any other laws or regulations which affect the Company's products or their production, handling or distribution could have a material adverse effect on the Company's operations.

**Trends in Consumer Preferences and Attitudes**

The domestic premium beer market has grown dramatically over the past decade. The Company believes that one factor in such growth has been consumer demand. No assurance can be given however that consumer demand for these products will continue in the future. The Company's success also depends upon a number of factors related to the level of discretionary consumer spending, such as the general state of the economy, tax laws and consumer confidence in future economic conditions.

**Protection of Intellectual Property Rights; Risk of Third Party Claims of Infringement**

The Company considers its trademarks, particularly certain brand names and product packaging, advertising and promotion design and artwork, to be of considerable value and critical to its business. The Company relies on trademark laws and other arrangements to protect its proprietary rights. There can be no assurance that the steps taken by the Company to protect its intellectual property rights will preclude competitors from developing similar brand names or promotional materials. While the Company believes that its proprietary rights do not infringe upon those third parties, it possesses no assurances of such a situation. The Company has applied for registration of the following trademarks: Russell, Fort Garry and Rocky Mountain.

**Dependence on Key Personnel**

The Company's success depends to a significant degree upon the continuing contributions of key personnel, and on its ability to attract and retain qualified management, sales, production and marketing personnel. The loss of any of such persons or the failure to recruit additional key personnel in a timely manner, could adversely affect the Company. The Company does not maintain any key man life insurance on any of its personnel.

**Operating Hazards**

The Company's operations are subject to certain hazards and liability risks faced by all brewers, such as the potential contamination of ingredients or products and equipment defects. While the Company has not experienced a contamination problem in its products, the occurrence of such a problem could result in a costly product recall and serious damage to the Company's reputation for product quality. Although the Company maintains insurance against certain risks under various general liability and product liability insurance policies, there can be no assurance that the Company's insurance will be adequate or that claims resulting from such incidents will be accepted as filed.



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**Trade Regulations**

The 1994 North America Free Trade Agreement ("NAFTA") among Canada, Mexico and the United States expanded the 1989 Free Trade Agreement between Canada and the United States. To date, NAFTA has had no material effect on the Company's business or operations. However, the adoption of new trade regulations or future trade disputes that result in retaliatory practices or increased tariffs between the United States and Canada could adversely affect the Company's business.

**Proprietary Rights**

Although the formulas for the Company's beers are proprietary trade secrets of the Company, there can be no assurance that others will not develop beers of the same or similar tastes and qualities as the Company's beers.

**Seasonal Nature of Business**

The alcoholic beverage industry in Canada is seasonal in nature. Accordingly, the Company has historically experienced a seasonal pattern in its operating results, with the second and third quarters historically exhibiting lower revenues. Therefore, the results in any one quarter are not indicative of results in any other quarter, or for the year as a whole.

**Uncertainty of Additional Capital**

In the past, the Company relied on the issuance of equity and debt securities to meet its capital requirements. The ability of the Company to arrange additional financing in the future will depend, in part, on the prevailing capital market conditions as well as the business performance of the Company. There can be no assurance that additional capital or other types of financing will be available if needed or that, if available, the terms of such financing will be favourable to the Company. If additional financing is raised by the Company through the issuance of securities from treasury, control of the Company may change and security holders may suffer significant dilution. The Company also requires continued support from its lenders to maintain its financial condition. The loss of this support could limit expansion opportunities and put strain on the Company's continuing operations.