



RUSSELL BREWERIES INC.
CONSOLIDATED INTERIM FINANCIAL
STATEMENTS
FOR THE NINE MONTHS ENDED
MARCH 31, 2011 AND 2010

UNAUDITED

NOTICE OF NO AUDITOR REVIEW OF 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 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.**CONSOLIDATED INTERIM BALANCE SHEETS****(UNAUDITED)**

| | March 31, 2011 | June 30, 2010 |
|--|---------------------------|--------------------------|
| ASSETS | | |
| CURRENT | | |
| Cash and cash equivalents | \$ 56,599 | \$ 42,552 |
| Accounts receivable | 633,295 | 961,274 |
| Inventories (Note 5) | 1,061,706 | 1,211,903 |
| Prepaid expenses and deposits | 126,105 | 117,690 |
| Due from related parties (Note 18(b)) | — | 45,392 |
| | 1,877,705 | 2,378,811 |
| PROPERTY AND EQUIPMENT (Note 6) | 3,408,120 | 3,652,166 |
| INTANGIBLE ASSETS (Note 7) | 1,937,153 | 1,933,653 |
| DEFERRED FINANCING COSTS | — | 19,832 |
| OTHER ASSETS (Note 8) | 100,000 | 200,000 |
| | \$ 7,322,978 | \$ 8,184,462 |
| LIABILITIES | | |
| CURRENT | | |
| Bank indebtedness (Note 19(c)) | \$ — | \$ 136,534 |
| Accounts payable and accrued liabilities | 1,690,397 | 2,113,826 |
| Exchangeable preferred shares dividend payable (Note 13) | 112,200 | 81,600 |
| Interest payable on convertible debentures | 27,883 | — |
| Demand loan (Note 9) | — | 125,000 |
| Current portion of long-term debt (Note 10) | 138,000 | 1,314,209 |
| Current portion of capital lease obligations (Note 11) | 33,597 | 97,395 |
| | 2,002,077 | 3,868,564 |
| LONG-TERM DEBT (Note 10) | 1,009,473 | 399,750 |
| CAPITAL LEASE OBLIGATIONS (Note 11) | 17,893 | 41,842 |
| CONVERTIBLE DEBENTURES (Note 12) | 512,239 | — |
| | 3,541,682 | 4,310,156 |
| SHAREHOLDERS' EQUITY | | |
| SHARE CAPITAL (Note 12) | 8,912,004 | 8,321,132 |
| EXCHANGEABLE RIGHTS (Note 12) | 126,484 | — |
| EXCHANGEABLE PREFERRED SHARES (Note 13) | 518,979 | 518,979 |
| CONTRIBUTED SURPLUS (Note 14) | 3,143,840 | 3,002,301 |
| DEFICIT | (8,920,011) | (7,968,106) |
| | 3,781,296 | 3,874,306 |
| | \$ 7,322,978 | \$ 8,184,462 |

NATURE OF OPERATIONS AND CONTINUANCE OF BUSINESS (Note 1)

COMMITMENTS AND CONTINGENCIES (Note 19)

Approved on behalf of the Board of Directors:

/s/ Andrew Harris

Andrew Harris, Director

/s/ Brian Harris

Brian Harris, Director

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

RUSSELL BREWERIES INC.**CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT
(UNAUDITED)**

| | Three Months Ended March 31, 2011 | Three Months Ended March 31, 2010 (Note 4) | Nine Months Ended March 31, 2011 | Nine Months Ended March 31, 2010 (Note 4) |
|--|--|---|---|--|
| REVENUES (Note 21) | \$ 1,809,346 | \$ 1,775,103 | \$ 5,702,104 | \$ 5,994,913 |
| LESS: EXCISE TAX AND PROVINCIAL MARK-UP | 318,973 | 389,864 | 1,204,451 | 1,389,361 |
| NET REVENUES | 1,490,373 | 1,385,239 | 4,497,653 | 4,605,552 |
| COST OF SALES | 871,841 | 768,093 | 2,405,138 | 2,170,444 |
| GROSS MARGIN | 618,532 | 617,146 | 2,092,515 | 2,435,108 |
| EXPENSES | | | | |
| Amortization | 116,745 | 142,361 | 349,021 | 426,646 |
| Selling, general and administrative (Note 17(a)) | 777,785 | 843,889 | 2,464,569 | 2,590,357 |
| | 894,530 | 986,250 | 2,813,590 | 3,017,003 |
| LOSS BEFORE OTHER INCOME (EXPENSE) | (275,998) | (369,104) | (721,075) | (581,895) |
| OTHER INCOME (EXPENSE) | | | | |
| Interest on long-term debt | (51,821) | (50,539) | (212,839) | (157,544) |
| Interest income | 613 | 130 | 1,812 | (1,221) |
| Other income | 5,545 | 4,092 | 10,797 | 29,321 |
| | (45,663) | (46,317) | (200,230) | (129,444) |
| LOSS AND COMPREHENSIVE LOSS FOR THE PERIOD | (321,661) | (415,421) | (921,305) | (711,339) |
| DEFICIT, BEGINNING OF PERIOD, AS PREVIOUSLY REPORTED | (8,588,150) | (8,579,244) | (7,968,106) | (8,039,463) |
| RESTATEMENT FOR CHANGE IN ACCOUNTING POLICY (Note 4) | — | 1,700,684 | — | 1,477,221 |
| DEFICIT, BEGINNING OF PERIOD, AS RESTATED | (8,588,150) | (6,878,560) | (7,968,106) | (6,562,242) |
| EXCHANGEABLE PREFERRED SHARES DIVIDENDS (Note 13) | (10,200) | (10,200) | (30,600) | (30,600) |
| DEFICIT, END OF PERIOD | \$ (8,920,011) | \$ (7,304,181) | \$ (8,920,011) | \$ (7,304,181) |
| EARNINGS (LOSS) PER SHARE (Note 15) | | | | |
| Basic and diluted | \$ (0.01) | \$ (0.01) | \$ (0.02) | \$ (0.02) |

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

RUSSELL BREWERIES INC.**CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS****(UNAUDITED)**

| | Three Months Ended March 31, 2011 | Three Months Ended March 31, 2010 (Note 4) | Nine Months Ended March 31, 2011 | Nine Months Ended March 31, 2010 (Note 4) |
|--|--|---|---|--|
| CASH FLOWS PROVIDED BY (USED FOR): | | | | |
| OPERATING ACTIVITIES | | | | |
| Net income (loss) for the period | \$ (321,661) | \$ (415,421) | \$ (921,305) | \$ (711,339) |
| Adjusted for non-cash items: | | | | |
| Amortization | 116,745 | 142,361 | 349,021 | 426,646 |
| Accretion of long-term debt | 18,151 | 33,752 | 86,942 | 102,374 |
| Stock-based compensation | — | — | 40,000 | — |
| | (186,765) | (239,308) | (445,342) | (182,319) |
| Net changes in non-cash working capital items: | | | | |
| Accounts receivable | 306,098 | 249,968 | 327,979 | 906,961 |
| Prepaid expenses and deposits | 13,310 | 60,720 | (8,415) | 61,953 |
| Inventories | 98,450 | (1,392) | 132,924 | (380,518) |
| Deferred financing costs | — | — | 19,832 | — |
| Interest payable on convertible debentures | 18,266 | — | 27,883 | — |
| Due to and from related parties | — | 2,958 | 45,392 | 9,434 |
| Accounts payable and accrued liabilities | (468,737) | 19,095 | (423,430) | (623,033) |
| | (219,378) | 92,041 | (323,177) | (207,522) |
| INVESTING ACTIVITIES | | | | |
| Purchases of property and equipment | (13,180) | (23,364) | (57,997) | (48,225) |
| Redemption of restricted cash | — | — | 100,000 | — |
| Acquisition of intangible assets | — | — | (3,500) | (813) |
| | (13,180) | (23,364) | 38,503 | (49,038) |
| FINANCING ACTIVITIES | | | | |
| Net proceeds from issuance of common shares | (10,579) | — | 664,459 | — |
| Net proceeds from issuance of convertible debenture | — | — | 666,675 | — |
| Proceeds from issuance of long term debts | — | — | 100,000 | — |
| Repayment of bank indebtedness | — | — | (136,534) | — |
| Repayment of long-term debt | (675,544) | (56,250) | (753,427) | (186,440) |
| Repayment of capital lease obligations | (18,150) | (33,269) | (117,452) | (103,128) |
| Repayment of demand loan, net of loan provided | — | — | (125,000) | — |
| | (704,273) | (89,519) | 298,721 | (289,568) |
| INCREASE(DECREASE) IN CASH AND CASH EQUIVALENTS | (936,831) | (20,842) | 14,047 | (546,128) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 993,430 | (36,670) | 42,552 | 488,616 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 56,599 | \$ (57,512) | \$ 56,599 | \$ (57,512) |
| CASH AND CASH EQUIVALENTS CONSIST OF: | | | | |
| Demand deposits | \$ 56,599 | \$ 30,108 | \$ 56,599 | \$ 30,108 |
| Line of credit | — | (87,620) | — | (87,620) |
| | \$ 56,599 | \$ (57,512) | \$ 56,599 | \$ (57,512) |

SUPPLEMENTAL CASH FLOW INFORMATION (Note 16)

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

1. NATURE OF OPERATIONS AND CONTINUANCE OF BUSINESS

Russell Breweries Inc. (the "Company") was incorporated under the laws of the Province of British Columbia, Canada on March 23, 2000. 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. Accordingly these unaudited consolidated financial statements do not reflect any adjustments in the carrying values of the assets and liabilities, the reported expenses, and the balance sheet classifications used that would be necessary if the going concern assumption were not appropriate. Such adjustments could be material.

As at March 31, 2011, the Company had a working capital deficit of \$124,372 and accumulated losses since inception of \$8,920,011. These factors raise substantial doubt about the Company's ability to continue as a going concern. 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. SIGNIFICANT ACCOUNTING POLICIES

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a basis consistent with those followed in the Company's most recent annual consolidated financial statements for the year ended June 30, 2010, except as described in note 3.

These unaudited interim consolidated financial statements do not include all note disclosures required by Canadian generally accepted accounting principles for annual financial statements, and therefore should be read in conjunction with the annual consolidated financial statements for the year ended June 30, 2010. In the opinion of management, all adjustments considered necessary for fair presentation of the Company's financial position, results of operations and cash flows have been included. Operating results for the nine-month period ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ending June 30, 2011.

Certain of the comparative figures have been restated as the Company has changed its accounting policy for the amortization of property and equipment (see Note 4).

3. RECENT ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements that have been announced but are not yet effective are as follows:

(i) CICA 1582, "Business Combinations", CICA 1601, "Consolidated Financial Statements" and CICA 1602, "Non-Controlling Interests"

In January 2009, the CICA issued Section 1582 "Business Combinations" to replace Section 1581. Prospective application of the standard is effective January 1, 2011, with early adoption permitted. This new standard effectively harmonizes the business combinations standard under Canadian GAAP with International Financial Reporting Standards ("IFRS"). The new standard revises guidance on the determination of the carrying amount of the assets acquired and liabilities assumed, goodwill and accounting for non-controlling interests at the time of a business combination. The CICA concurrently issued Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-Controlling Interests," which replace Section 1600 "Consolidated Financial Statements."

3. RECENT ACCOUNTING PRONOUNCEMENTS (continued)

(i) CICA 1582, "Business Combinations", CICA 1601, "Consolidated Financial Statements" and CICA 1602, "Non-Controlling Interests" (continued)

Section 1601 provides revised guidance on the preparation of consolidated financial statements and Section 1602 addresses accounting for non-controlling interests in consolidated financial statements subsequent to a business combination. These standards are effective January 1, 2011, unless they are early adopted at the same time as Section 1582 "Business Combinations." The Company is currently assessing the impact of adopting these standards and has not yet determined its effect on its financial statements.

(ii) CICA 3251, "Equity"

In August 2009, Section 3251 Equity was issued in response to issuing Section 1602 Non-controlling Interests. The amendments require non-controlling interests to be recognized as a separate component of equity. The amendments apply only to entities that have adopted Section 1602. The adoption of this section is not expected to have a material impact on the financial statements.

(iii) CICA 1625, "Comprehensive Revaluation of Assets and Liabilities"

In August 2009, Section 1625 Comprehensive Revaluation of Assets and Liabilities was issued for consistency with new Section 1582 Business Combinations. The amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011. The adoption of this section is not expected to have a material impact on the financial statements.

(iv) International Financial Reporting Standards

In February 2008, the CICA Accounting Standards Board confirmed that public companies will be required to prepare interim and annual financial statements under IFRS for fiscal years beginning on or after January 1, 2011. The Company is currently assessing the impact of adopting IFRS and has not yet determined its effect on its financial statements.

4. CHANGE IN ACCOUNTING POLICY

During the year ended June 30, 2010, the Company determined that it was more appropriate to recognize amortization of property and equipment using the straight-line method as it better reflected the economic usage of the related assets. The Company previously recognized amortization using the declining balance method. As a result of the change in accounting policy, the comparative financial statements for the period ended March 31, 2010 have been restated as follows:

| | As Previously Reported | Change | As Restated |
|---|------------------------------|---------------|----------------|
| For the three months ended March 31, 2010 | | | |
| Statement of Operations: | | | |
| Amortization | \$ 249,855 | \$ (107,494) | \$ 142,361 |
| Net income (loss) | (522,915) | 107,494 | (415,421) |
| Earnings (loss) per share – basic and diluted | (0.02) | 0.01 | (0.01) |
| Deficit, beginning of period | 8,579,245 | (1,700,685) | 6,878,560 |
| Deficit, end of period | 9,112,360 | (1,808,179) | 7,304,181 |
| Balance Sheet: | | | |
| Property and equipment | 1,878,029 | 1,808,179 | 3,686,208 |
| Deficit | \$ 9,112,360 | \$(1,808,179) | \$ 7,304,181 |

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE NINE MONTHS ENDED MARCH 31, 2011 AND 2010****4. CHANGE IN ACCOUNTING POLICY (continued)**

| For the nine months ended March 31, 2010 | As Previously Reported | Change | As Restated |
|---|------------------------------|---------------|----------------|
| Statement of Operations: | | | |
| Amortization | \$ 757,604 | \$ (330,958) | \$ 426,646 |
| Net income (loss) | (1,042,297) | 330,958 | (711,339) |
| Earnings (loss) per share – basic and diluted | (0.03) | 0.01 | (0.02) |
| Deficit, beginning of period | 8,039,463 | (1,477,221) | 6,562,242 |
| Deficit, end of period | 9,112,360 | (1,808,179) | 7,304,181 |
| Balance Sheet: | | | |
| Property and equipment | 1,878,029 | 1,808,179 | 3,686,208 |
| Deficit | \$ 9,112,360 | \$(1,808,179) | \$ 7,304,181 |

5. INVENTORIES

| | March 31, 2011 | June 30, 2010 |
|--|-------------------|------------------|
| Finished goods and work-in-progress | \$ 416,124 | \$ 396,682 |
| Raw materials | 395,180 | 521,788 |
| Supplies | 60,968 | 63,911 |
| Returnable containers, net of amortization | 189,434 | 229,522 |
| | \$ 1,061,706 | \$ 1,211,903 |

As at March 31, 2011, returnable containers includes kegs and small ware with a cost of \$847,200 (June 30, 2010 – \$840,357) and accumulated amortization of \$656,993 (June 30, 2010 – \$618,206).

6. PROPERTY AND EQUIPMENT

| | Cost | Accumulated Amortization | March 31, 2011 Net Book Value | June 30, 2010 Net Book Value |
|-------------------------------|--------------|-----------------------------|--|---------------------------------------|
| Computers | \$ 71,075 | \$ 67,950 | \$ 3,125 | \$ 2,309 |
| Equipment | 5,810,848 | 2,754,005 | 3,056,843 | 3,237,913 |
| Leasehold improvements | 1,307,827 | 1,207,442 | 100,385 | 131,634 |
| Office furniture and fixtures | 61,993 | 51,371 | 10,622 | 4,110 |
| Vehicles | 519,599 | 282,454 | 237,145 | 276,115 |
| Website | 5,975 | 5,975 | – | 85 |
| | \$ 7,777,317 | \$ 4,369,197 | \$ 3,408,120 | \$ 3,652,166 |

As at March 31, 2011, equipment includes assets under capital leases with a cost of \$310,359 (June 30, 2010 – \$280,654) and accumulated amortization of \$58,088 (June 30, 2010 – \$46,821). As at March 31, 2011, vehicles includes assets under capital leases with a cost of \$494,694 (June 30, 2010 – \$494,694) and accumulated amortization of \$249,675 (June 30, 2010 – \$212,574).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE NINE MONTHS ENDED MARCH 31, 2011 AND 2010**

7. INTANGIBLE ASSETS

| | | March 31, 2011 | | June 30, 2010 |
|-----------------------|----|---------------------------|----|------------------|
| Brands and trademarks | \$ | 1,937,153 | \$ | 1,933,653 |

8. OTHER ASSETS

| | | March 31, 2011 | | June 30, 2010 |
|--------------------------|----|---------------------------|----|------------------|
| Restricted term deposits | \$ | 100,000 | \$ | 200,000 |

A term deposit of \$100,000 has been pledged as security for a \$100,000 bank line of credit (June 30, 2010 – \$100,000). During the period ended March 31, 2011, the Company redeemed \$100,000 term deposit in connection with a buy out of a capital lease. As at March 31, 2011, no term deposit has been pledged as security for capital leases (June 30, 2010 – \$100,000).

9. DEMAND LOAN

On June 18, 2010, the Company entered into a loan facility agreement with a primary lender under which the lender and its partners may advance up to \$500,000 to the Company at their discretion. The purpose of the loan is to finance amounts receivable from the British Columbia Liquor Distribution Branch. Amounts advanced bear interest at the lesser of 2% of the average loan balance during the month and 2% of the proceeds advanced under the agreement. The loan is repayable on demand and is secured by a general security agreement of the assets of the Company and by specific assignment of a joint signing account. On November 16, 2010, the Company paid off this loan.

10. LONG-TERM DEBT

| | March 31, 2011 | June 30, 2010 |
|--|---------------------------|------------------|
| Term bank loan, bearing interest at 7.8%, repayable in monthly installments of \$18,750 plus interest prior to October 2010 and \$9,750 plus interest thereafter maturing November 15, 2014, secured by the assets of Fort Garry (a) | 417,250 | 543,750 |
| 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) | 92,750 | – |
| Discount loan, bearing interest at 10% per annum compounded semi-annually, \$738,600 due July 31, 2011, secured by the assets of Russell and Fort Garry (c) | 637,473 | 1,170,209 |
| | 1,147,473 | 1,713,959 |
| Less: current portion of long-term debt | (138,000) | (1,314,209) |
| Long-term portion of long-term debt | \$ 1,009,473 | \$ 399,750 |

10. LONG-TERM DEBT (continued)

- (a) On December 8, 2008, the bank made an amendment to the existing term loan in accordance with the request of the Company for 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 \$100,000 pre-authorized working capital loan from Business Development Bank of Canada. 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.
- (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. 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 March 31, 2011, the fair value of this early settlement option was estimated to be \$nil.

On December 31, 2010, the Company entered into an amendment and extension loan agreement to the loan agreement dated December 31, 2007, pursuant to which the lender 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. Russell may repay the Loan at any time without penalty by paying the discounted Loan advance amount of \$620,000 together with accumulated interest. The Loan is guaranteed by Russell Brewing Company Ltd. and Fort Garry Brewing Company Ltd., both wholly-owned subsidiaries of the Company. During the period ended March 31, 2011, the Company recorded interest expense of \$86,942 (2010 - \$102,374) 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.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE NINE MONTHS ENDED MARCH 31, 2011 AND 2010**

10. LONG-TERM DEBT (continued)

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

| Fiscal Year | Amount |
|-------------|--------------|
| 2011 | \$ 641,750 |
| 2012 | 138,000 |
| 2013 | 758,000 |
| 2014 | 138,000 |
| 2015 | 69,750 |
| 2016 | 3,500 |
| | <hr/> |
| | \$ 1,749,000 |

11. CAPITAL LEASE OBLIGATIONS

The Company finances certain property and equipment using capital leases which bear interest at rates ranging from 1% to 35.85% and expire on various dates through August 2013. Estimated future minimum lease payments under these capital leases are as follows:

| | Amount |
|--|-----------|
| Fiscal Year: | |
| 2011 | \$ 4,378 |
| 2012 | 42,641 |
| 2013 | 12,254 |
| Total minimum lease payments | 59,273 |
| Less: amount representing interest | (7,783) |
| Net minimum lease payments | 51,490 |
| Less: current portion of capital lease obligations | (33,597) |
| Long-term portion of capital lease obligations | <hr/> |
| | \$ 17,893 |

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

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

(b) Issued and Outstanding Share Capital

| | Common Shares | Amount |
|--|------------------|--------------|
| Balance, June 30, 2009, 2010 | 33,325,437 | \$ 8,321,132 |
| Issued during the year | | |
| For cash | | |
| Private placement, net of share issue costs | 12,730,000 | 540,872 |
| For services | | |
| Shares issued for corporate finance services | 625,000 | 50,000 |
| Balance, March 31, 2011 | 46,680,437 | <hr/> |
| | | \$8,912,004 |

12. SHARE CAPITAL (continued)**(c) Private Placement**

During the period ended March 31, 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") announced previously on October 5, 2010 and October 25, 2010 (together, the "Offerings"). The first tranche of each of the Offerings closed on November 4, 2010, the second tranche of each of the Offerings closed on December 3, 2010, and the third tranche closed on December 24, 2010.

Under the Unit Offering, the Company issued 12,730,000 units (the "Units"), at a purchase 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 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 and are redeemable by the Company upon maturity at a price of \$0.15. The Convertible Debentures bear interest at 10% per annum, payable quarterly in arrears. The conversion rights were assigned a fair value of \$183,550 which was determined using the Black-Scholes option-pricing model.

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 issued 625,000 common shares to the Agent as a corporate finance fee. Other share issue costs were \$252,101. These agent warrants were assigned a fair value of \$73,587 for the Units and \$27,952 for the Convertible Debentures which was determined using the Black-Scholes option-pricing model.

The securities issued pursuant to the Offerings are subject to a hold period of four months and one day from the date of issue in compliance with securities laws and the policies of the TSX Venture Exchange, as applicable.

(d) 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.V. Vesting terms are determined by the board of directors on the date of grant.

On October 18, 2010, the Company granted 100,000 incentive stock options to a director 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 \$0.06 calculated using the Black-Scholes option-pricing model at the date of grant using the following assumptions: expected option life for 5 years; risk-free interest rate of 1.97%; expected dividend yield of 0% and expected stock price volatility of 87% (see Note 14).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE NINE MONTHS ENDED MARCH 31, 2011 AND 2010**

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

On November 18, 2010, the Company amended the exercise price of 1,872,500 options held by employees, directors and officers of the Company to a new price of \$0.10. The re-pricing of options held by insiders of the Company is approved by shareholders of the Company, excluding votes cast by common shares beneficially owned by insiders of the Company and associates of such insiders, at the annual and special general meeting of the Company held in 2010. The incremental weighted average fair value of each option re-priced was \$0.018 calculated using the Black-Scholes option-pricing model at the date of re-pricing using the following assumptions: expected option life from 0.40 to 2.59 years; risk-free interest rate of 1.42%; expected dividend yield of 0% and expected stock price volatility from 106% to 116% (see Note 14).

Stock option activity for the period ended March 31, 2011 is presented below:

| | March 31, 2011 | | |
|----------------------------------|---------------------|----|--|
| | Number of Shares | | Weighted Average Exercise Price |
| Outstanding, beginning of period | 2,245,000 | \$ | 0.41 |
| Granted | 100,000 | | 0.10 |
| Cancelled for re-pricing | (1,872,500) | | 0.42 |
| Re-priced options | 1,872,500 | | 0.10 |
| Forfeited | (717,500) | | 0.23 |
| Outstanding, ending of period | 1,627,500 | \$ | 0.10 |

At March 31, 2011, the following stock options are outstanding:

| Number of Options | Weighted Average Exercise Price | Expiry Date |
|----------------------|--|------------------|
| 550,000 | 0.10 | October 20, 2011 |
| 140,000 | 0.10 | August 29, 2012 |
| 837,500 | 0.10 | June 19, 2013 |
| 100,000 | 0.10 | October 18, 2015 |
| 1,627,500 | 0.10 | |

On April 13, 2011, 345,000 stock options exercisable at \$0.10 expired unexercised.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE NINE MONTHS ENDED MARCH 31, 2011 AND 2010**

12. SHARE CAPITAL (continued)**(e) Warrants**

Warrant activity for the period ended March 31, 2011 is presented below:

| March 31, 2011 | | | |
|------------------------------------|---------------------|----|--|
| | Number of Shares | | Weighted Average Exercise Price |
| Outstanding, beginning of period | 6,665,087 | \$ | 0.25 |
| Issued for private placement units | 12,730,000 | | 0.15 |
| Issued for agent warrants | 2,120,200 | | 0.08 |
| Outstanding, ending of period | 21,515,287 | \$ | 0.17 |

At March 31, 2011, 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 | Note |
|-----------------------|--|-------------------|----------------|
| 6,665,087 | \$ 0.25 | June 8, 2011 | |
| 10,402,500 | 0.15 | November 4, 2012 | |
| 1,673,100 | 0.08 | November 4, 2012 | Agent warrants |
| 827,500 | 0.15 | December 3, 2012 | |
| 225,700 | 0.08 | December 3, 2012 | Agent warrants |
| 1,500,000 | 0.15 | December 23, 2012 | |
| 221,400 | 0.08 | December 23, 2012 | Agent warrants |
| 21,515,287 | 0.17 | | |

13. EXCHANGEABLE PREFERRED SHARES

On March 31, 2008, the Company's wholly-owned subsidiary, Russell Brewing Company Ltd. ("Russell"), completed a brokered private placement for 68,000 exchangeable, non-voting preferred shares (the "Exchangeable Shares") at a price of \$10 per share for gross proceeds of \$680,000 under the Equity Capital Program of the Province of British Columbia (the "Program"). In connection with the private placement, the Company issued 6,800 agent warrants allowing the holder to purchase 16.67 common shares of the Company per warrant at a price of \$0.60 per common share until March 31, 2010. These agent warrants were assigned a fair value of \$21,396 which was determined using the Black-Scholes option-pricing model. The Company also paid a commission of \$54,400 and incurred other cash issuance costs of \$60,000.

The Exchangeable Shares have a 6% per annum cumulative dividend, payable semi-annually, in accordance with rules under the Program. After five years (the "Exchange Date"), each Exchangeable Share will automatically be exchanged into 16.67 common shares of the Company, or earlier if certain events occur, including a change in control of the Company or an insolvency event in Russell. At the Exchange Date, the exchange ratio will be increased for any penalty incurred or for any unpaid dividends.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE NINE MONTHS ENDED MARCH 31, 2011 AND 2010**

13. EXCHANGEABLE PREFERRED SHARES (continued)

Russell will incur a penalty if it has not paid all cumulative dividends due and payable as of March 31, 2011 and for any unpaid dividends calculated each six months thereafter until the Exchange Date. The maximum penalty would result in one additional common share of the Company being exchanged for each Exchangeable Share. The exchange ratio will also increase to account for any unpaid dividends at the Exchange Date such that the additional number of the Company's common shares to be issued is equal to the unpaid dividend amount divided by \$0.60. As at March 31, 2011, the unpaid dividend amount was \$112,200 (June 30, 2010 - \$81,600). The Company did not pay the dividend due and payable as of March 31, 2011. The maximum penalty may result in an aggregate of 68,000 additional common share of the Company being issued at the Exchange Date.

14. CONTRIBUTED SURPLUS

| | March 31, 2011 |
|--|---------------------------|
| Balance, beginning of period | \$ 3,002,301 |
| Fair value of stock options granted | 6,000 |
| Incremental fair value of stock options due to re-pricing | 34,000 |
| Fair value of warrants attached to the private placement Units | 73,587 |
| Fair value of warrants attached to convertible debentures | 27,952 |
| Balance, end of period | \$ 3,143,840 |

15. EARNINGS (LOSS) PER SHARE

Net loss available to common shareholders in the computation of loss per share is as follows:

| | March 31, 2011 | March 31, 2010 |
|--|---------------------------|-------------------|
| Net income (loss) and comprehensive loss | \$ (921,305) | \$ (711,339) |
| Dividends on exchangeable preferred shares | (30,600) | (30,600) |
| Net loss available to common shareholders | \$ (951,905) | \$ (741,939) |

The weighted average number of shares outstanding used in the computation of loss per share for the period ended March 31, 2011 was 40,183,256 (2010 – 33,325,437). Outstanding stock options, warrants, agent warrants and agent unit options have not been considered in the computation of diluted loss per share as the result is anti-dilutive.

16. SUPPLEMENTAL CASH FLOW INFORMATION

| | March 31, 2011 | March 31, 2010 |
|---|---------------------------|-------------------|
| Cash paid for: | | |
| Interest | \$ 86,942 | \$ 102,37 |
| Income taxes | – | – |
| Non-cash investing and financing activities: | | |
| Capital lease obligations recognized for assets under capital lease | \$ 29,705 | \$ – |
| Common shares issued for services | \$ 50,000 | \$ – |

17. RELATED PARTY TRANSACTIONS AND BALANCES

- (a) During the period ended March 31, 2011, the Company incurred salaries and wages expense of \$116,250 to relatives of directors of the Company (2010 – \$111,000) and salaries of \$28,000 to a director of the Company (2010 – \$36,000 in consulting fees). 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.
- (b) As at March 31, 2011, the Company is owed \$nil (June 30, 2010 – \$45,392) from two officers and a director of the Company. The amounts were non-interest bearing, unsecured and due on demand.

18. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS**(a) Fair Values of Financial Instruments**

The carrying values of cash and cash equivalents, accounts receivable, due from related parties, other assets, bank indebtedness, accounts payable, exchangeable preferred share dividend payable and demand loan 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 capital lease obligations at March 31, 2011 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 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.

18. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS
(continued)

(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 March 31, 2011, the Company has significant accounts receivable from one major customer totalling \$234,158 (June 30, 2010 - \$258,941). The Company manages credit risk for trade and other receivables through established credit monitoring activities. As at March 31, 2011, the Company's maximum exposure to credit risk is the carrying value of cash and cash equivalents, accounts receivable, due from related parties and other assets.

(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 March 31, 2011 are as follows:

| | Less Than 1 Year \$ | Years 2 and 3 \$ | Years 4 and 5 \$ | More Than 5 Years \$ | Total \$ |
|------------------------------------|------------------------------------|---------------------------------|---------------------------------|-------------------------------------|---------------------|
| Bank indebtedness | — | — | — | — | — |
| Accounts payable | 1,690,397 | — | — | — | 1,690,397 |
| Dividend payable | 112,200 | 91,800 | — | — | 204,000 |
| Long-term debt | 641,750 | 896,000 | 207,750 | 3,500 | 1,749,000 |
| Interest on convertible debentures | 83,693 | 64,457 | — | — | 148,150 |
| Capital lease obligations | 4,378 | 54,895 | — | — | 59,273 |
| | 2,532,418 | 1,107,152 | 207,750 | 3,500 | 3,850,820 |

As at March 31, 2011, the Company had a working capital deficit of \$124,372. During the period ended March 31, 2011, the Company completed financings with gross proceeds totaling \$1,759,150 (see Note 12).

(iii) Interest Rate Price Risk

The Company's cash equivalents, when held, 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. Certain of the Company's long-term debt instruments and capital lease obligations are subject to interest rate price risk as they carry fixed rates of interest.

(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 period.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE NINE MONTHS ENDED MARCH 31, 2011 AND 2010**

19. COMMITMENTS AND CONTINGENCIES

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

| Fiscal Year | Amount |
|-------------|---------------------|
| 2011 | 74,502 |
| 2012 | 391,073 |
| 2013 | 335,323 |
| 2014 | 225,422 |
| 2015 | 231,048 |
| | <u>\$ 1,257,368</u> |

- (b) As at March 31, 2011, 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, matures on January 18, 2011 and is secured by a term deposit of \$100,000 (see Note 8).

20. 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 (2010 - \$200,000) related to its bank line of credit and capital leases (see Note 8). 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 shareholders' equity, convertible debenture, long-term debt and capital leases as capital, which consists of the following:

| | March 31, 2011 | June 30, 2010 |
|---------------------------|---------------------|---------------------|
| Convertible debenture | \$ 512,239 | \$ – |
| Long-term debt | \$ 1,147,473 | \$ 1,713,959 |
| Capital lease obligations | 51,490 | 139,237 |
| Shareholders' equity | 3,781,296 | 3,874,306 |
| | <u>\$ 5,492,498</u> | <u>\$ 5,727,502</u> |

21. MAJOR CUSTOMER

During the period ended March 31, 2011, the Company had sales of \$2,758,096 (2010 – \$2,862,490) to the Manitoba Liquor Control Commission which accounted for 48% of its gross revenues (2010 – 48%).