



RUSSELL BREWERIES INC.
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED
JUNE 30, 2014 AND 2013

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Russell Breweries Inc.

We have audited the accompanying consolidated financial statements of Russell Breweries Inc. which comprise the consolidated statements of financial position as at June 30, 2014 and 2013, and the consolidated statements of comprehensive income (loss), changes in equity and cash flows for the years then ended, and the related notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained based on our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Russell Breweries Inc. as at June 30, 2014 and 2013 and its financial performance and cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Manning Elliott LLP

CHARTERED ACCOUNTANTS
Vancouver, British Columbia
October 24, 2014

RUSSELL BREWERIES INC.**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION****AS AT JUNE 30, 2014 AND 2013**(Expressed in Canadian Dollars)

	2014	2013
ASSETS		
Current		
Cash and cash equivalents	\$ 662,056	\$ 213,452
Accounts receivable	833,078	1,124,666
Inventories (Note 5)	867,530	664,046
Prepaid expenses and deposits	200,710	143,981
Due from related parties	-	17,738
	2,563,374	2,163,883
PROPERTY AND EQUIPMENT (Note 6)	2,573,345	2,849,850
INTANGIBLE ASSETS (Note 7)	1,935,268	1,935,268
RESTRICTED TERM DEPOSITS (Note 8)	100,000	100,000
LONG-TERM INVESTMENT (Note 10)	100,000	100,000
	\$ 7,271,987	\$ 7,149,001
LIABILITIES		
Current		
Bank indebtedness (Note 20(c))	\$ 36,966	\$ 36,671
Accounts payable and accrued liabilities	810,713	1,416,363
Income taxes payable	171,000	-
Due to related parties (Notes 9 and 18)	215,100	105,662
Current portion of long-term debt (Note 11)	286,417	966,226
Current portion of finance lease obligations (Note 12)	27,052	32,329
	1,547,248	2,557,251
LONG-TERM DEBT (Note 11)	565,653	68,609
FINANCE LEASE OBLIGATIONS (Note 12)	26,651	68,131
UNEARNED LICENSE FEES (Note 13)	56,250	81,250
DEFERRED TAX LIABILITIES (Note 15(a))	698,000	729,000
	2,893,802	3,504,241
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 14)	12,283,087	11,783,304
SHARE-BASED PAYMENTS RESERVES	3,570,648	3,398,726
DEFICIT	(11,475,550)	(11,537,270)
	4,378,185	3,644,760
	\$ 7,271,987	\$ 7,149,001

COMMITMENTS AND CONTINGENCIES (Note 20 and 23)
SUBSEQUENT EVENTS (Note 25)

Approved and authorized for issuance on behalf of the Board of Directors on October 24, 2014:

/s/ Benjamin Li Yu
Benjamin Li Yu, Director/s/ Peter H. Stafford
Peter H. Stafford, Director

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

RUSSELL BREWERIES INC.**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**(Expressed in Canadian Dollars)

	2014	2013
GROSS REVENUES (Note 22)	\$ 9,451,371	\$ 8,691,831
LESS: EXCISE TAX AND PROVINCIAL MARK-UP	1,905,912	1,959,605
NET REVENUES	7,545,459	6,732,226
COST OF SALES (Notes 5 and 24)	3,302,614	3,147,820
GROSS MARGIN	4,242,845	3,584,406
EXPENSES		
Depreciation	79,506	120,775
Selling, general and administrative (Notes 18 and 24)	3,797,159	3,591,734
	3,876,665	3,712,509
EARNINGS (LOSS) BEFORE OTHER INCOME (EXPENSE)	366,180	(128,103)
OTHER INCOME (EXPENSE)		
Interest on finance lease obligations	(18,355)	(22,689)
Interest on long-term debt and convertible debt	(157,959)	(218,199)
Other expenses	(15,850)	(10,000)
Interest income	2,704	1,622
Other income (Note 13)	25,000	18,750
	(164,460)	(230,516)
INCOME (LOSS) BEFORE INCOME TAXES	201,720	(358,619)
INCOME TAXES (Note 15)		
Current tax expense	(171,000)	-
Deferred tax recovery (expense)	31,000	(187,000)
	(140,000)	(187,000)
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) FOR THE YEAR	61,720	(545,619)
EARNINGS (LOSS) PER SHARE (Note 16)		
Basic and diluted	\$ 0.00	\$ (0.01)

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

RUSSELL BREWERIES INC.**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

	Share Capital			Convertible Debentures \$	Preferred Shares	Share-based Payments Reserves \$	Deficit \$	Total Shareholders' Equity \$
	Number of Shares	Value \$	Allotted Shares					
Balance, June 30, 2013	78,350,455	11,783,304	—	—	—	3,398,726	(11,537,270)	3,644,760
Comprehensive income	—	—	—	—	—	—	61,720	61,720
Shares issued, net of share issue costs	8,733,333	499,783	—	—	—	—	—	499,783
Share-based compensation	—	—	—	—	—	(1,193)	—	(1,193)
Fair value of warrants issued	—	—	—	—	—	173,115	—	173,115
Balance, June 30, 2014	87,083,788	12,283,087	—	—	—	3,570,648	(11,475,550)	4,378,185
Balance, June 30, 2012	62,230,562	9,772,163	5,440	86,484	518,979	3,361,624	(10,950,851)	2,793,839
Comprehensive loss	—	—	—	—	—	—	(545,619)	(545,619)
Shares issued, net of share issue costs	9,640,000	455,488	—	—	—	—	—	455,488
Conversion of convertible debentures	4,938,333	827,234	—	(86,484)	—	—	—	740,750
Conversion of preferred shares	1,133,560	518,979	—	—	(518,979)	—	—	—
Conversion of dividend payable on preferred shares	340,000	204,000	—	—	—	—	—	204,000
Conversion of penalty for unpaid interest on preferred shares	68,000	5,440	(5,440)	—	—	—	—	—
Share-based compensation	—	—	—	—	—	37,102	—	37,102
Dividends on preferred shares	—	—	—	—	—	—	(40,800)	(40,800)
Balance, June 30, 2013	78,350,455	11,783,304	—	—	—	3,398,726	(11,537,270)	3,644,760

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

RUSSELL BREWERIES INC.**CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**(Expressed in Canadian Dollars)

	2014	2013
CASH FLOWS PROVIDED BY (USED IN):		
OPERATING ACTIVITIES		
Net income (loss)	\$ 61,720	\$ (545,619)
Adjusted for non-cash items:		
Deferred income tax (recovery) expense	(31,000)	187,000
Depreciation	392,667	442,738
Accretion of long-term debt	49,123	96,507
Accrued interest on long-term debt	26,477	-
Accretion of convertible debentures	-	71,909
Recognition of unearned license fees (Note 13)	(25,000)	(18,750)
Other expenses	15,850	-
Bad debt expense	45,123	-
Share-based compensation (Note 14(c))	(1,193)	37,102
	533,767	270,887
Net changes in non-cash working capital items:		
Accounts receivable	246,466	(248,136)
Prepaid expenses and deposits	(54,841)	(9,499)
Inventories	(203,484)	71,806
Due to and from related parties	1,711	(80,847)
Income taxes payable	171,000	-
Accounts payable and accrued liabilities	(605,650)	(38,750)
	88,969	(34,539)
INVESTING ACTIVITIES		
Purchase of property and equipment	(116,162)	(30,104)
FINANCING ACTIVITIES		
Shares issued, net of share issuance costs	499,783	455,488
Proceeds from long-term debt	500,000	-
Interest payable on convertible debentures	-	(18,519)
Proceeds from demand loan	100,000	-
Proceeds from bank indebtedness	295	878
Repayment of long-term debt	(543,446)	(133,391)
Repayment of finance lease obligations	(46,757)	(55,560)
Payment of financing costs on long-term debt	(34,078)	-
	475,797	248,896
INCREASE IN CASH AND CASH EQUIVALENTS	448,604	184,253
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	213,452	29,199
CASH AND CASH EQUIVALENTS, ENDING OF YEAR	\$ 662,056	\$ 213,452
CASH AND CASH EQUIVALENTS CONSIST OF:		
Demand deposits	\$ 662,056	\$ 213,452

SUPPLEMENTAL CASH FLOW INFORMATION (Note 17)

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

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

1. NATURE OF OPERATIONS

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

These consolidated financial statements ("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.

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

These Financial Statements are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

(b) Basis of Presentation, Functional Currency and Basis of Consolidation

These Financial Statements include the accounts of Russell Breweries Inc. and its wholly owned subsidiaries Russell Brewing Company Ltd. ("Russell") and Fort Garry Brewing Company Ltd. ("Fort Garry"). The Financial Statements also include the accounts of Russell USA LLC, an entity which the Company exercised control over as at June 30, 2014. The following companies have been consolidated with Russell Breweries Inc. as at June 30, 2014:

Company Name	Registered	Holding	Functional Currency
Russell Breweries Inc.	British Columbia	Parent Company	Canadian Dollar
Russell Brewing Company Ltd.	British Columbia	100%	Canadian Dollar
Fort Gary Brewing Company Ltd.	New Brunswick	100%	Canadian Dollar
Russell USA LLC (Note 2 (b)(i))	United States	0%	United States Dollar

- (i) As at June 30, 2014 the Company owned a 0% interest in Russell USA LLC, however was able to exercise control of the entity, therefore it has been consolidated.
- (ii) Inter-company balances and transactions, and any unrealized gains arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

(c) Basis of Measurement

The Financial Statements have been prepared on the historical cost basis, presented in Canadian dollars, except where otherwise indicated.

2. STATEMENT OF COMPLIANCE AND BASIS OF PRESENTATION (continued)

(d) Significant Accounting Estimates and Judgments

The preparation of these financial statements requires management to make judgments in applying accounting policies. Judgments that have the most significant effect on the amounts recognized in the Financial Statements are described below. Management also makes assumptions and critical estimates. Critical estimates are those which are most subject to uncertainty and have the most significant risk of resulting in a material change to the carrying amounts of assets and liabilities within the next year. Judgments, assumptions and estimates are based on historical experience, business trends and all available information that management considers relevant at the time of the preparation of the Financial Statements. However, future events and their effects cannot be anticipated with certainty and so as confirming events occur, actual results could ultimately differ from assumptions and estimates. Such differences could be material.

The following discusses the most significant accounting judgments and estimates that the Company has made in the preparation of these Financial Statements.

(i) Significant Judgments

Going Concern

Assessment of the Company's ability to continue as a going concern requires estimates of future cash flows and includes the consideration of other factors, the outcomes of which are uncertain.

Deferred Income Taxes

Deferred tax liabilities require management judgment in order to determine the amounts to be recognized. This includes assessing the timing of the reversal of temporary differences to which deferred income tax rates are applied.

Impairment Assessments of Long-Lived Assets

Impairment indicators include a significant decline in an asset's market value, significant changes in the technological, market, economic or legal environment in which the assets are operated, evidence of obsolescence or physical damage of an asset, significant changes in the planned use of an asset, or ongoing under-performance of an asset. Application of these factors to the facts and circumstances of a particular asset requires a significant amount of judgment.

Long-term Investment

The Company holds shares in another company as a long-term investment and must use judgment to determine whether its ownership interest along with other factors (see Note 10), results in significant influence over the other company such that the Company will account for its long-term investment using the equity method of accounting or the cost method of accounting.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

2. STATEMENT OF COMPLIANCE AND BASIS OF PRESENTATION (continued)**(d) Significant Accounting Estimates and Judgments****(ii) Significant Estimates**

Significant areas requiring the use of management estimates include 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 including property and equipment and intangible assets, valuation of warrants, and other share-based payments, recognition of deferred income tax assets, deferred income tax rates and estimates of contingent liabilities.

3. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with IFRS and reflect management's consideration of the following significant accounting policies:

(a) Financial Instruments**(i) Cash and Cash Equivalents**

Cash and cash equivalents, when applicable, are designated as fair value through profit or loss ("FVTPL") and include cash on account, demand deposits and money market investments with maturities from the date of acquisition of 90 days or less, which are readily convertible to known amounts of cash and are subject to insignificant changes in value.

(ii) Trade Receivables and Payables

Trade receivables and payables are non-interest bearing and stated at carrying values, which approximate fair values due to their short terms to maturity. Where necessary, trade receivables include allowances for uncollectible amounts. Trade receivables are designated as loans and receivables and trade payables are designated as other financial liabilities.

(iii) Long-term Investment

The long-term investment in Russell Breweries (China) Inc. is designated as available-for-sale and is measured at cost as it does not have a quoted market price in an active market and whose fair value cannot be reliably measured on an ongoing basis.

(iv) Restricted Term Deposits and Bank Indebtedness

Restricted term deposits and bank indebtedness are designated as FVTPL and are recorded at fair value with gains and losses recorded in the consolidated statement of comprehensive income (loss).

(v) Long-Term Debt and Due to Related Parties

Long-term debt and due to related parties are designated as other financial liabilities and initially recorded at total proceeds received less direct issuance costs. Long-term debt and due to related parties are subsequently measured at amortized cost calculated using the effective interest rate method.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (continued)**(a) Financial Instruments (continued)****(vi) Derivative Instruments**

Derivative instruments, including embedded derivatives, are recorded on the consolidated statement of financial position at fair value and designated as FVTPL. Unrealized gains and losses on derivatives are recorded in net earnings. Fair values for derivative instruments are determined using valuation techniques. These valuations use assumptions based on market conditions existing at the consolidated statement of financial position date. Derivatives embedded in non-derivative contracts are recognized separately unless they are closely related to the host contract.

(b) Inventories

Raw materials, supplies, finished goods and work-in-progress are valued at the lower of cost, determined using the first-in, first-out method, and net realizable value. The cost of finished goods and work-in-progress includes direct materials, labour and overhead costs.

Inventories are written down to net realizable value if that net realizable value is less than the carrying amount of the inventory item at the reporting date. If the net realizable value subsequently increases, a reversal of the loss initially recognized is applied to cost of sales.

(c) Property and Equipment**(i) Depreciation Methods and Rates**

Property and equipment is recorded at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the useful lives of the assets which are estimated as follows:

Computer hardware and software	2-4	Years
Equipment	7-25	Years
Office furniture and fixtures	5	Years
Vehicles	10	Years
Refundable containers	7	Years

Leasehold improvements are depreciated using the straight-line method over the estimated term of the related lease.

(ii) Repairs and Maintenance

Repairs and maintenance costs are charged to expense as incurred, except when these repairs significantly extend the life of an asset or result in an operating improvement. In these instances, the portion of these repairs relating to the betterment is capitalized as part of property and equipment.

(d) Intangible Assets

Intangible assets are assets acquired that lack physical substance and that meet the specified criteria for recognition apart from goodwill. Intangible assets are comprised of brands and trademarks. Brands and trademarks held by the Company have an indefinite life and, therefore, are not amortized (see Note 3(e)).

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Intangible Assets (continued)

The assessment of brands and trademarks as having an indefinite useful life is based on the prospects for long-term profitability and the overall positioning of the brands and trademark in the market in terms of notoriety and volume.

Brands and trademarks are measured at cost less any impairment in value.

(e) Impairment of Financial and Non-financial Assets

Assets that have an indefinite useful life, such as brands and trademarks, are not subject to amortization and are tested for impairment annually, or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Assets that are subject to depreciation and amortization, such as property and equipment and intangible assets with finite lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

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 costs to sell and its value-in-use. Such reviews are undertaken on an asset-by-asset basis, except where assets do not generate cash flows independent of other assets, in which case the review is undertaken at the cash-generating unit level.

Where a cash-generating unit includes intangible assets which are either not available for use or which have an indefinite useful life (and which can only be tested as part of a cash-generating unit), an impairment test is performed at least annually or whenever there is an indication that the carrying amounts of such assets may be impaired.

If the carrying amount of an individual asset or cash-generating unit exceeds its recoverable amount, an impairment loss is recorded in the consolidated statement of comprehensive income (loss) to reflect the asset at the recoverable amount. In assessing the value-in-use, the relevant future cash flows expected to arise from the continuing use of such assets and from their disposal are discounted to their present value using a pre-tax discount rate which reflects the current market's assessments of the time value of money and asset-specific risks for which the cash flow estimates have not been adjusted. Fair value less costs to sell is determined as the price that would be received to sell the asset or group of assets in an orderly transaction between market participants at the measurement date less incremental costs directly attributed to the disposal of the asset or group of assets.

A reversal of a previously recognized impairment loss is recorded in the consolidated statement of comprehensive income (loss) when events or circumstances dictate that the estimates used to determine the recoverable amount have changed since the prior impairment loss was recognized. The carrying amount is increased to the recoverable amount but not beyond the carrying amount net of amortization which would have arisen if the prior impairment loss had not been recognized. After such a reversal, the amortization charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(f) Revenue Recognition

The Company recognizes net sales revenue on product sales at the time the product is shipped. At the time of shipment the following criteria for revenue recognition exist: title has transferred to the provincial liquor boards or retail customers according to the shipping terms, the Company no longer retains managerial involvement with the product associated with ownership, the amount of revenue and costs incurred with respect to the underlying transaction are measured reliably, and collection of the related receivable is probable. Anticipated product returns are provided for at the time of sale. Net revenue represents gross revenues less applicable excise taxes and fees levied by provincial liquor boards. Royalty revenue is recorded in accordance with the contract terms once it can be reliably measured and it is probable that the economic benefits associated with the transaction will flow to the Company. License fee revenue is recorded as other income on a straight-line basis over the life of the related license agreement once it can be reliably measured and it is probable that the economic benefits associated with the transaction will flow to the entity.

(g) Share-Based Compensation

The Company uses the fair value based method of accounting for share-based compensation for all awards of shares and share options granted.

The Company grants stock options to executive officers, directors, employees and consultants pursuant to a stock option plan described in Note 14(c).

The fair value of options granted is recognized as an employee or consultant expense with a corresponding increase in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee.

Where the share options are awarded to employees, the fair value is measured at grant date, and each tranche is recognized on the graded vesting method over the period during which the options vest. The fair value of the options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. At each financial position reporting date, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

Where equity instruments are granted to non-employees, they are recorded at the fair value of the goods or services received in the consolidated statement of comprehensive income (loss), unless the fair value cannot be estimated reliably, in which case they are recorded at the fair value of the equity instruments granted.

(h) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Deferred tax assets and liabilities are determined based on temporary differences between the accounting and tax bases of existing assets and liabilities, and are measured using the substantively enacted tax rates which apply when these differences are expected to reverse. Deferred tax assets are recognized for all deductible temporary differences, tax loss carryforwards and tax credit carryforwards to the extent that it is probable that taxable profit will be available against which they can be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the date of the statement of financial position.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (continued)**(h) Income taxes** (continued)

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to offset current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority and the taxable entities intend to either settle current tax liabilities and assets on a net basis, or to realize the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax assets or liabilities are expected to be settled or recovered.

(i) Earnings/Loss per Share

Basic earnings/loss per share is computed by dividing net earnings/loss by the weighted average number of common shares outstanding during the period. Diluted earnings/loss per share is calculated by adjusting the weighted average number of common shares outstanding using the treasury stock method, to reflect the potential dilution of securities that could result from the exercise of "in the money" stock options, warrants, agent warrants and agent unit options.

(j) Financing Costs

Professional, consulting and regulatory fees as well as other costs directly attributable to financing transactions are reported as deferred financing costs until the transactions are completed, if the completion of the transaction is considered to be more likely than not. Share issue costs are charged to share capital when the related shares are issued. Debt issue costs are offset against the related financial instrument on the date of issuance. Costs relating to financial transactions that are not completed, or for which successful completion is considered unlikely, are charged to operations. Costs incurred in connection with the modification of long-term debt are offset against the related debt or recognized as part of the gain or loss on extinguishment of the existing debt.

(k) Leases

Leases are classified as either finance or operating leases. A lease that transfers substantially all of the benefits and risks incidental to the ownership of property is classified as a finance lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred. At the inception of a finance lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property's fair market value at the beginning of such lease. Assets recorded under finance leases are amortized on a straight-line basis over the estimated useful lives of the respective assets on commencement of use of the related assets.

(l) Provisions

Provisions are recorded when a present legal or constructive obligation exists as a result of past events where it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The increase in the provision due to passage of time is recognized as accretion expense.

(m) Operating segments

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Executive Officer who is considered to be the Company's 'chief-operating decision maker'. The Chief Executive Officer has determined that the Company operates in a single industry and operating segment which involves the production, distribution and sale of beer in Canada. All property, and equipment are situated in Canada.

4. ADOPTION OF NEW ACCOUNTING STANDARDS

(a) Newly adopted accounting standards

The mandatory adoption of the following new and revised accounting standards and interpretations on July 1, 2013 had no significant impact on the Company's Financial Statements for the current year or prior year presented. The following standards were adopted for the year ended June 30, 2014:

- Amendments to IFRS 7 – Financial Instruments: Disclosures
- IFRS 10 – Consolidated Financial Statements
- IFRS 11 – Joint Arrangements
- IFRS 12 – Disclosure of Interest in Other Entities
- IFRS 13 – Fair Value Measurement
- IAS 19 – Employee Benefits
- IAS 27 – Separate Financial Statements
- IAS 28 – Investments in Associates and Joint Ventures
- Amended and re-titled IAS 27 Separate Financial Statements, and IAS 28 Investments in Associates and Joint Ventures, as a consequence of new IFRS 10, IFRS 11 and IFRS 12.
- Amendments to IAS 1 – Presentation of Financial Statements

(b) Future changes in accounting standards

Certain new standards, interpretations and amendments to existing standards have been issued by the IASB or the International Financial Reporting Interpretations Committee ("IFRIC") that are mandatory for future accounting periods. Some updates that are not applicable or are not consequential to the Company may have been excluded from the list below.

New accounting standards effective January 1, 2014

- IAS 32 *Financial Instruments: Presentation* - In December 2011, the IASB issued an amendment to clarify the meaning of the offsetting criterion and the principle behind net settlement, including identifying when some gross settlement systems may be considered equivalent to net settlement. Earlier application is permitted when applied with corresponding amendments to IFRS 7.
- IAS 36 *Impairment of Assets* - In May 2013, the IASB issued an amendment to address the disclosure of information about the recoverable amount of impaired assets or a cash-generating unit ("CGU") for periods in which an impairment loss has been recognized or reversed. The amendments also address disclosure requirements applicable when and asset's or a CGU's recoverable amount is based on fair value less costs of disposal.
- IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* - In May 2014, the IASB issued amendments to IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets. The amendments clarify that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The amendments also clarify that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. This presumption, however, can be rebutted in certain limited circumstances.

4. ADOPTION OF NEW ACCOUNTING STANDARDS

(b) Future change in accounting policies

New accounting standards effective January 1, 2017

- IFRS 15 – *Revenue from Contracts with Customers* - IFRS 15 was issued in May 2014 and specifies how and when an entity will recognize revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers.

New accounting standards effective January 1, 2018

- IFRS 9 – *Financial Instruments* – IFRS 9 was initially issued in November 2008 and contains requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: Amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at the fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent not clearly representing a return of investment; however, others gains and losses (including impairments) associated with such instruments remain in accumulated other comprehensive income indefinitely.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement*, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

IFRS 9 was subsequently amended in November 2013 to add new general hedge accounting requirements. The final version of IFRS 9 was issued in July 2014 and adds a new expected loss impairment model and amends the classification and measurement model for financial assets by adding a new fair value through other comprehensive income category for certain debt instruments and additional guidance on how to apply the business model and contractual cash flow characteristics. IFRS 9 is effective for annual periods beginning on or after January 1, 2018 with early adoption permitted.

The extent of the impact of adoption of these standards and interpretations on the Financial Statements of the Company has not yet been determined.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

5. INVENTORIES AND COST OF SALES

	2014	2013
Finished goods	\$ 118,273	\$ 113,662
Work-in-progress	259,503	190,540
Raw materials	489,754	359,844
	\$ 867,530	\$ 664,046

During the year ended June 30, 2014, charges of \$Nil (2013 – \$Nil) were recorded in cost of sales relating to obsolete, damaged or unsellable finished goods inventory.

There were no reversals of amounts previously charged to cost of sales in respect of write-downs of inventory for the years ended June 30, 2014 and June 30, 2013.

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

	2014	2013
Inventories	\$ 2,987,320	\$ 2,826,117
Depreciation	315,294	321,703
	\$ 3,302,614	\$ 3,147,820

RUSSELL BREWERIES INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

(Expressed in Canadian Dollars)

6. PROPERTY AND EQUIPMENT

	Computer \$	Equipment \$	Leasehold improvements \$	Office furniture and fixtures \$	Vehicles \$	Returnable containers \$	Total \$
Cost							
Balance as at June 30, 2012	69,285	5,913,242	1,307,826	63,844	519,599	863,772	8,737,568
Additions	–	48,461	1,731	–	42,815	31,867	124,874
Balance as at June 30, 2013	69,285	5,961,703	1,309,557	63,844	562,414	895,639	8,862,442
Additions	8,116	72,189	33,419	–	(9,685)	12,123	116,162
Balance as at June 30, 2014	77,401	6,033,892	1,342,976	63,844	552,729	907,762	8,978,604
Accumulated Depreciation							
Balance as at June 30, 2012	69,009	3,092,442	1,275,121	59,878	347,404	726,128	5,569,982
Depreciation	276	288,288	32,750	3,966	54,921	62,409	442,610
Balance as at June 30, 2013	69,285	3,380,730	1,307,871	63,844	402,325	788,537	6,012,592
Depreciation	419	260,640	1,965	–	56,660	72,983	392,667
Balance as at June 30, 2014	69,704	3,641,370	1,309,836	63,844	458,985	861,520	6,405,259
Carrying amounts							
June 30, 2012	276	2,820,800	32,705	3,966	172,195	137,644	3,167,586
June 30, 2013	–	2,580,973	1,686	–	160,089	107,102	2,849,850
June 30, 2014	7,697	2,392,522	33,140	–	93,744	46,242	2,573,345

Equipment includes assets under finance leases with a cost of \$439,719 (June 30, 2013 – \$439,719) and accumulated depreciation of \$99,159 (June 30, 2013 – \$88,650). Vehicles includes assets under finance leases with a cost of \$537,509 (June 30, 2013 – \$537,509) and accumulated depreciation of \$416,873 (June 30, 2013 – \$363,122).

RUSSELL BREWERIES INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013
(Expressed in Canadian Dollars)

7. INTANGIBLE ASSETS

	Brands and Trademarks	Website	Total
Cost			
Balance as at June 30, 2012	\$ 1,935,268	\$ 5,975	\$ 1,941,243
Balance as at June 30, 2013	\$ 1,935,268	\$ 5,975	\$ 1,941,243
Balance as at June 30, 2014	\$ 1,935,268	\$ 5,975	\$ 1,941,243
Accumulated Depreciation			
Balance as at June 30, 2012	\$ –	\$ 5,975	\$ 5,975
Balance as at June 30, 2013	\$ –	\$ 5,975	\$ 5,975
Balance as at June 30, 2014	\$ –	\$ 5,975	\$ 5,975
Carrying amounts			
June 30, 2012	\$ 1,935,268	\$ –	\$ 1,935,268
June 30, 2013	\$ 1,935,268	\$ –	\$ 1,935,268
June 30, 2014	\$ 1,935,268	\$ –	\$ 1,935,268

8. RESTRICTED TERM DEPOSIT

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

9. BRIDGE LOAN DUE TO RELATED PARTIES

On September 3, 2013, the Company entered into a bridge loan agreement with the spouses of certain directors of the Company 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 is one year from the date of the Bridge Loan Agreement and the principal and accrued interest are 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. As part of the Bridge Loan Agreement, 400,000 common shares of the Company were issued to the lenders as consideration for agreeing to advance the loans to the Company. The shares were issued with an estimated fair value of \$0.05 per share for a total value of \$20,000, which was recorded as a financing cost against the value allocated to the loan.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**(Expressed in Canadian Dollars)

9. BRIDGE LOAN DUE TO RELATED PARTIES (continued)

During the year ended June 30, 2014, the Company recorded interest expense of \$17,951 related to the accretion of the discounted value of the loan, which has been recorded as interest on long-term debt in the consolidated statement of comprehensive income (loss). The Bridge Loan may be prepaid, at any time, without premium or penalty. As at June 30, 2014, the total amount owing including interest is \$105,678 which was recorded as due to related parties (see Note 18(h)). The Bridge Loan is secured by a security agreement over the present and future real property of the Company.

10. LONG-TERM INVESTMENT

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

The Company has used the cost method to account for its investment due to the fact that the Company has no significant influence over the Licensee's management of operations (see Note 13). As of June 30, 2014, the Company's interest in the Licensee has decreased to 7.69%.

11. LONG-TERM DEBT

	June 30, 2014	June 30, 2013
Term bank loan, bearing interest at a floating base rate plus a variance of 1%, repayable in monthly installments of \$9,750 plus interest prior to October 2010 and thereafter repayable in monthly installments of \$9,750 plus interest maturing November 15, 2014, secured by the assets of Fort Garry (a)	\$ 48,750	\$ 165,750
Term bank loan, bearing interest at floating base rate plus a variance of 1%, repayable in monthly installments of \$1,750 plus interest maturing August 15, 2015, secured by the assets of Fort Garry (b)	22,896	40,859
Discount loan, bearing interest at 10% per annum compounded semi-annually, \$836,834 due July 31, 2013, secured by the assets of Russell and Fort Garry (c)	–	828,226
Term loan, bearing interest at 10% per annum calculated semi-annually, repayable in monthly installments of \$17,500 plus bonus and interest maturing on July 31, 2016, secured by the assets of Russell and Fort Garry (c)	444,121	–
Term loan due to related parties, bearing interest at 9% per annum calculated semi-annually, secured by a guarantee by a director of the Company, due December 31, 2015 (e)	336,303	–
	852,070	1,034,835
Less: current portion of long-term debt	(286,417)	(966,226)
Long-term portion of long-term debt	\$ 565,653	\$ 68,609

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

11. 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 a six-month principal postponement. Pursuant to the amendment, the remaining loan amount on December 8, 2008 of \$787,500 was to be repaid by 42 consecutive monthly principal installments of \$18,750 each commencing June 15, 2009 and ending November 15, 2012. The bank also granted a reduction of the interest rate on the term loan by 1%. With the exception of the amendments agreed, all terms and conditions of the term loan remained unchanged. On September 22, 2010, the bank made a further amendment to the existing term loan in accordance with the request of the Company. Pursuant to the amendment, the remaining loan amount is to be repaid by 50 consecutive monthly principal installments of \$9,750 each commencing October 15, 2010 and ending November 15, 2014.
- (b) On October 5, 2010, the Company's subsidiary Fort Garry Brewing Company Ltd. accepted an offer of a \$100,000 pre-authorized working capital loan from Business Development Bank of Canada ("BDC"). The BDC Loan, bearing interest at floating base rate plus a variance of 1% maturing August 15, 2015, is secured by the assets of Fort Garry and supported by a guarantee made by two directors of the Company. In return for the guarantee, the Company issued 250,000 common shares of the Company as bonus shares with an estimated fair value of \$0.08 per share for a total value of \$20,000, which was recorded as a financing cost against the value allocated to the loan. During the period ended June 30, 2014, the Company recorded interest expense of \$3,037 (2013 - \$4,609) related to the accretion of the discounted value of the loan, which has been recorded as interest on long-term debt in the consolidated statement of comprehensive income (loss).
- (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.

On December 31, 2010, the Company entered into an amendment and loan extension agreement to the loan agreement dated December 31, 2007, pursuant to which the lender extended the maturity date to July 31, 2012 and reduced the loan amount to \$738,600 from \$1,239,000, provided that the Company repay the loan in the amount of \$619,000 on January 1, 2011 (paid). Pursuant to the amended loan agreement, the lender provided to the Company a new loan valued at maturity in the amount of \$738,600. The discounted value or loan advance amount of \$620,000 was 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 also earned a bonus of \$22,500, which was included in the loan amount. The term of the loan is 19 months. The Company may repay the loan at any time without penalty by paying the discounted loan advance amount of \$620,000 together with accumulated interest.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

11. LONG-TERM DEBT (continued)

(c) (continued)

On July 11, 2012, the Company agreed to a one-year extension and amendment to the loan agreement dated December 31, 2007. The extension is for one year, maturing on July 31, 2013 and bears interest at 10% per annum, calculated semi-annually. In consideration of the lender's agreement to amend and extend the loan, the lender will earn a bonus of \$24,374. The Company may repay the loan at any time without penalty by paying the outstanding loan amount together with accumulated interest and prorated bonus. The extension is guaranteed by Russell Brewing Company Ltd. and Fort Garry Brewing Company Ltd., both wholly-owned subsidiaries of the Company. As security for the loan, the Company will grant to the lender a subordinated security agreement creating a security interest and charge over all of their respective property and assets subordinate to senior debt and senior security of up to \$2.5 million plus finance lease obligations incurred for future acquisitions of equipment and other capital assets. On July 31, 2013, the Company repaid \$206,834 of the loan. The discounted value of the loan as at June 30, 2014 was \$444,121.

(d) On July 26, 2013, the Company negotiated to further amend and extend repayment of the balance of \$630,000 of the loan in Note 11(c). 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. The loan amount of \$650,000 was amended and extended as follows: a 10% per annum interest rate, calculated semi-annually, repayable in monthly installments of \$17,500 plus bonus and interest, subject to a penalty of \$17,500 for each missed monthly installment payment, and maturing July 31, 2016. 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.

During the year ended June 30, 2014, the Company recorded interest expense of \$12,732 (2013 - \$96,507) related to the accretion of the discounted value of the loan, which has been recorded as interest on long-term debt in the consolidated statement of comprehensive income (loss).

(e) On January 20, 2014, the Company entered into a loan agreement with Weichun Ye, Yan Zeng and Dongbing (Derrick) Ma, (the "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 warrant entitling the Guarantor to purchase one common share of the Company at an exercise price of \$0.05 per share until December 31, 2015 (Note 14(d)). The Company has granted to the lenders of this loan security interest in all present and future undertakings and property of the Company as described in the security agreement.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

11. LONG-TERM DEBT (continued)

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

<u>Fiscal Year</u>		<u>Amount</u>
2015	\$	279,750
2016		713,500
2017		17,500
	\$	1,010,750

12. FINANCE LEASE OBLIGATIONS

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

<u>Fiscal Year:</u>		<u>Amount</u>
2015	\$	37,293
2016		27,483
Total minimum lease payments		64,776
Less: amount representing interest		(11,073)
Net minimum lease payments		53,703
Less: current portion of finance lease obligations		(27,052)
Long-term portion of finance lease obligations	\$	26,651

13. UNEARNED LICENSE FEES

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

Pursuant to the License Agreement, the Company received an initial licensing fee of \$100,000 (See Note 10). In addition, the Company will be entitled to ongoing royalties of \$23 per hectolitre of beer produced and sold by the Licensee. The term of the agreement is for four years and expires on October 1, 2016.

During the period ended June 30, 2014, the Company has recognized \$nil in royalties and \$25,000 in license fees earned under the agreement, which has been recorded as other income in the consolidated statement of comprehensive income (loss). As at June 30, 2014, the unearned license fee is \$56,250 (2013 - \$81,250).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

14. 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 Share Capital

During the year ended June 30, 2013, the Company redeemed its convertible debentures maturing on November 4, 2012, December 3, 2012 and December 23, 2012 (the "Redemption Dates"). On the Redemption Dates, the Company fully redeemed the principal amount of the convertible debentures totaling \$740,750 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.

On January 2, 2014, the Company issued 400,000 common shares with an estimated fair value of \$20,000 as bonus shares to the spouses of certain directors who provided the Company with a loan of \$100,000 pursuant to a bridge loan agreement entered into on September 3, 2013 (see Note 9).

During the year ended June 30, 2014, the Company completed in two tranches, a non-brokered private placement of common shares. The first tranche closed on May 7, 2014 and the final tranche closed on June 17, 2014. Under the private placement, the Company issued and sold 8,333,333 common shares at a purchase price of \$0.06 for aggregate gross proceeds of \$500,000.

(c) Stock Options

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

During the year ended June 30, 2013, 1,222,220 stock options previously granted to key employees and directors vested net of forfeited incentive stock options. The Company recorded a total amount of \$37,102 compensation cost included in selling, general and administrative expense relating to these options.

During the year ended June 30, 2014, 50,000 stock options previously granted to key employees and directors vested net of forfeited incentive stock options. The Company recorded a total amount of \$1,193 compensation recovery included in selling, general and administrative expense relating to these options.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**(Expressed in Canadian Dollars)

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

Stock option activity during the years ended June 30, 2014 and 2013 is presented below:

	2014		2013	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	1,300,000	\$ 0.10	4,077,500	\$ 0.10
Expired	—	—	(977,500)	0.10
Forfeited	(1,250,000)	0.10	(1,800,000)	0.10
Outstanding, end of year	50,000	0.10	1,300,000	0.10

Certain directors and officers of the Company resigned resulting in forfeiture of 1,250,000 stock options during the year ended June 30, 2014.

At June 30, 2014, the following stock options are outstanding:

Options Outstanding			Options Exercisable		
Exercise Price \$	Number of Shares	Weighted Average Remaining Life (in years)	Weighted Average Exercise Price \$	Number of Shares	Weighted Average Exercise Price \$
0.10	50,000	2.69	0.10	50,000	0.10

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**(Expressed in Canadian Dollars)

14. SHARE CAPITAL (continued)**(d) Warrants**

Warrant activity during the years ended June 30, 2014 and 2013 is presented below:

	2014		2013	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	9,640,000	\$ 0.10	20,380,000	\$ 0.13
Granted	4,000,000	0.05	9,640,000	0.10
Expired	–	–	(20,380,000)	0.13
Outstanding, end of year	13,640,000	\$ 0.09	9,640,000	\$ 0.10

During the year ended June 30, 2014, the Company granted 4,000,000 non-transferable warrants to a director for guaranteeing the \$500,000 loan with Weichun Ye, Yan Zeng and Dongbing (Derrick) Ma (“Guarantor”) (see Note 11(d)). The warrants are exercisable at \$0.05 per share and expire December 31, 2015. If the Company repays any of the \$500,000 principal amount prior to January 20, 2015 the warrants, to the extent not already exercised, cancel on a pro rata basis based on the amount repaid relative to the principal amount. During the year ended June 30, 2014, the Company recognized \$173,115 for the fair value of these warrants in share-based payment reserves with a corresponding entry recorded as a financing cost against long-term debt.

Warrant pricing requires the use of highly subjective estimates and assumptions including the expected stock price volatility. The expected volatility used in valuing these warrants is based on volatility observed in historical periods. Changes in the underlying assumptions can materially affect the fair value estimates. The fair value of the warrants granted to the director during the year ended June 30, 2014 as consideration for a loan guarantee as described above was calculated using the Black-Scholes option pricing model with the following weighted average assumptions and resulting grant date fair value:

	2014
Weighted average assumptions:	
Risk-free interest rate	0.94%
Expected dividend yield	0%
Forfeiture rate	0%
Expected option life (years)	2 years
Expected stock price volatility	211%
Weighted average fair value at grant date	\$ 0.03

RUSSELL BREWERIES INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

(Expressed in Canadian Dollars)

14. SHARE CAPITAL (continued)

(f) Warrants (continued)

At June 30, 2014, the following warrants were outstanding entitling the holders the right to purchase one common share for each warrant held:

Number of Warrants	Weighted Average Exercise Price	Expiry Date
9,640,000	\$ 0.10	May 17, 2015
4,000,000	0.05	December 31, 2015
13,640,000	\$ 0.09	

15. INCOME TAXES

(a) Deferred Tax Assets and Liabilities

The significant components of the Company's deferred tax assets and liabilities are as follows:

	2014	2013
Deferred tax assets:		
Non-capital losses carried forward	\$ 3,030,000	\$ 2,972,000
Tax value of property and equipment in excess of book value	228,000	177,000
Tax value of intangible assets in excess of book value	4,000	4,000
Tax value of debt in excess of book value	(50,000)	-
Share and debt issue costs available to be deducted for tax purposes	47,000	58,000
	3,259,000	3,211,000
Unrecognized deferred tax assets	(3,259,000)	(3,211,000)
Net deferred tax assets	\$ -	\$ -
Deferred tax liabilities:		
Book value of property and equipment in excess of tax value	(251,000)	\$ (290,000)
Book value of intangible assets in excess of tax value	(447,000)	(439,000)
Deferred tax liabilities	(698,000)	(729,000)
Net deferred tax assets (liabilities)	\$ (698,000)	\$ (729,000)

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**(Expressed in Canadian Dollars)

15. INCOME TAXES (continued)**(b) Non-Capital Losses Carried Forward and Expiration Dates**

The Company has non-capital losses of approximately \$11,654,000 which may be carried forward to apply against future years income tax for Canadian income tax purposes, subject to final determination by taxation authorities, and expiring as follows:

<u>Fiscal Year of Expiry</u>	<u>Amount</u>
2014	\$ 74,000
2015	283,000
2026	257,000
2027	750,000
2028	1,696,000
2029	2,213,000
2030	1,831,000
2031	1,937,000
2032	1,150,000
2033	722,000
2034	741,000
	<u>\$ 11,654,000</u>

(c) Income tax expense

Income tax expense included in the consolidated statement of comprehensive income (loss) is as follows:

	<u>2014</u>	<u>2013</u>
Current income tax (expense) recovery	\$ (171,000)	\$ –
Deferred income tax (expense) recovery	31,000	(187,000)
Total income tax expense	<u>\$ (140,000)</u>	<u>\$ (187,000)</u>

(d) Reconciliation of Tax Rates

The Company is subject to Canadian federal and provincial taxes at an approximate rate of 26.00% (2013 – 25.25%) for the year ended June 30, 2014. The reconciliation of the provision for income taxes at the statutory rate compared to the Company's income tax expense as reported is as follows:

	<u>2014</u>	<u>2013</u>
(Income) loss before income taxes	\$ (201,720)	\$ 358,619
Statutory tax rate	26.00%	25.25%
Expected income tax (expense) recovery at statutory rates	(53,000)	91,000
Permanent differences	(41,000)	(25,000)
Changes in tax rates	–	122,000
Changes in estimates and other	2,000	(13,000)
Change in unrecognized deferred tax assets	(48,000)	(362,000)
Income tax expense	<u>\$ (140,000)</u>	<u>\$ (187,000)</u>

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

16. EARNINGS (LOSS) PER SHARE

The computation of net earnings (loss) per share attributable to common shareholders is as follows:

Basic		2014
Net income	\$	61,720
Common shares outstanding, beginning of year		78,350,455
Weighted average number of common shares issued during the year		1,288,630
Basic number of common shares outstanding during the year		79,639,085
Basic income per share	\$	0.00
Diluted		2014
Net income	\$	61,720
Basic number of common shares outstanding during the year		79,639,085
Weighted average number of common shares issuable on dilutive options and warrants, during the year		1,142,857
Diluted number of common shares outstanding during the year		80,781,942
Diluted income per share	\$	0.00

For the year ended June 30, 2013 basic loss per share equals diluted loss per share as the effect of any potentially dilutive securities were anti-dilutive and accordingly the diluted calculations are not presented.

17. SUPPLEMENTAL CASH FLOW INFORMATION

	2014	2013
Cash paid for:		
Interest	\$ 82,763	\$ 67,863
Income taxes	—	—
Non-cash investing and financing activities:		
Finance lease obligations recognized for assets under finance lease	—	94,898
Investment in Licensee (Note 10)	—	100,000
Common shares issued for convertible debentures	—	827,234
Common shares issued for exchangeable preferred shares	—	518,979
Common shares issued for penalty for unpaid interest on preferred shares	—	5,440
Common shares issued for dividend payable on preferred shares	—	204,000
Bonus shares issued on loan extension agreement (Note 11(b))	20,000	—
Non-transferable warrants issued (Note 14(d))	\$ 173,115	\$ —

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**(Expressed in Canadian Dollars)

18. RELATED PARTY TRANSACTIONS AND BALANCES

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

	2014	2013
Short-term benefits:		
Salaries, management & consulting fees [Notes 18(a), (b) & (c)]	\$ 550,083	\$ 290,000
Directors fees [Note 18(d)]	35,484	20,356
Legal fees [Note 18(e)]	13,375	118,629
Accounting fees [Note 18(f) & (g)]	42,293	125,000
Share-based payments [Note 11(c)]	(1,193)	37,102
Total short-term benefits:	\$ 640,042	\$ 591,087
Termination benefits [Note 18 (b)]	160,400	-
	\$ 800,442	\$ 591,087

- (a) During the year ended June 30, 2014, the Company incurred management fees and salaries totaling \$519,309 to a company controlled by the CEO and other key management (2013 – \$nil). As at June 30, 2014, the Company owed \$23,167 to the CEO and a company controlled by the CEO (2013 – \$1,500), which is non-interest bearing, unsecured and due on demand.
- (b) During the year ended June 30, 2014, the Company incurred management and consulting fees of \$24,000 (2013 – \$145,000) and termination benefits of \$160,400 (2013 - \$nil) to a company controlled by the former CEO. As at June 30, 2014, the Company owed \$24,000 to the former CEO through a company controlled by the former CEO (2013 – \$5,592), which is non-interest bearing, unsecured and due on demand.
- (c) During the year ended June 30, 2014, the Company incurred management fees of \$6,774 to a company controlled by the former COO (2013 – \$145,000). As at June 30, 2014, the Company owed \$nil to the former COO and a company controlled by the former COO (2013 – \$1,804), which was non-interest bearing, unsecured and due on demand.
- (d) During the year ended June 30, 2014, the Company incurred director fees of \$35,484 (2013 - \$20,356). As at June 30, 2014, the Company owed \$18,000 to the independent directors (2013 – \$26,119), which is non-interest bearing, unsecured and due on demand.
- (e) During the year ended June 30, 2014, the Company accrued legal fees of \$13,375 (2013 - \$118,629) to a company controlled by a former director of the Company. As at June 30, 2014, the Company had received invoices totaling \$44,255 from this company.
- (f) During the year ended June 30, 2014, the Company incurred accounting fees of \$33,333 to a company controlled by the former CFO of the Company (2013 – \$125,000). As at June 30, 2014, the Company owed \$nil to this company (2013 – \$23,498), which was non-interest bearing, unsecured and due on demand.
- (g) During the year ended June 30, 2014, the Company incurred salaries and wages expense of \$52,231 (2013 – 131,758) and accounting fees of \$8,960 (2013 - \$10,560) to relatives of former directors and officers of the Company. As at June 30, 2014, the Company owed \$nil to relatives of former directors of the Company (2013 - \$4,394), which was non-interest bearing, unsecured and due on demand.
- (h) As at June 30, 2014, the Company owed \$105,678 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 accrued interest of \$7,727 and is net of unamortized debt issuance costs of \$2,029 (see Notes 9 and 24(b)).

18. RELATED PARTY TRANSACTIONS AND BALANCES (continued)

- (i) During the year ended June 30, 2014, the Company issued 4,000,000 non-transferable warrants to Dongbing (Derrick) Ma, a director of the Company, for guaranteeing the loan between the Company and Weichun Ye and Yan Zeng (Note 11 (e)).

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.

19. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS

(a) Fair Values of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, restricted term deposits, bank indebtedness, accounts payable, and due to related parties are reasonable estimates of fair values due to the relatively short periods to maturity and the commercial terms of these instruments. The carrying values of long-term debt and finance lease obligations at June 30, 2014 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 the Company's 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.

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) inputs.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

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

Financial assets and liabilities measured at fair value on a recurring basis were presented on the Company's June 30, 2014 consolidated statement of financial position as follows:

Fair Value Measurements Using					
	Quoted Prices in Active Markets For Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of June 30, 2014	
Assets:					
Cash and cash equivalents	\$ 662,056	\$ -	\$ -	\$ 662,056	
Restricted term deposits	100,000	-	-	100,000	
Liabilities:					
Bank indebtedness	\$ 36,966	\$ -	\$ -	\$ 36,966	

(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 restricted term deposits with major financial institutions. Deposits held with these institutions may exceed the amount of insurance provided on such deposits. As at June 30, 2014, the Company has significant accounts receivable from one major customer totaling \$391,908 (June 30, 2013 - \$379,715). The Company manages credit risk for trade and other receivables through established credit monitoring activities. As at June 30, 2014, the Company's maximum exposure to credit risk is the carrying value of cash and cash equivalents, accounts receivable and restricted term deposits.

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

	2014		2013	
	Over 90 days	Total	Over 90 days	Total
Provincial Liquor Boards	\$ -	\$ 741,080	3,057	\$ 669,347
Other receivables	-	91,198	72,065	455,319
Total	\$ -	\$ 833,078	\$ 75,122	\$ 1,124,666

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

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

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

(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 June 30, 2014 are as follows:

	Less Than 1 Year \$	Years 2 and 3 \$	Years 4 and 5 \$	More than 5 Years \$	Total \$
Bank indebtedness	36,966	–	–	–	36,966
Accounts payable and accrued liabilities	810,713	–	–	–	810,713
Due to related parties and long-term debt	279,750	731,000	–	–	1,010,750
Finance lease obligations	27,052	37,724	–	–	64,776
	1,154,481	768,724	–	–	1,923,205

As at June 30, 2014, the Company had a positive working capital of \$1,016,126 (2013 – negative working capital of \$393,368).

(iii) Interest Rate Price Risk

Certain of the Company's long-term debt instruments and finance lease obligations are subject to interest rate price risk as they carry fixed rates of interest.

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 income (loss) and comprehensive income (loss) for the year.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

20. COMMITMENTS AND CONTINGENCIES

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

<u>Fiscal Year</u>	<u>Amount</u>
2015	\$ 566,421
2016	429,355
2017	323,138
2018	323,138
2019	329,716
	<u>\$ 1,971,768</u>

- (b) At June 30, 2014, the Company had issued a general excise bond of \$55,000 in favour of the Minister of National Revenue of Canada.
- (c) The Company has a bank operating line of credit with a limit of \$100,000 which bears interest at prime plus 1%, matures on October 31, 2015 and is extended automatically on a quarterly basis, and is secured by a term deposit of \$100,000 (see Note 8). As at June 30, 2014, \$100,000 is undrawn from the line of credit.

The Company's bank indebtedness of \$36,966 at June 30, 2014, represents cheques issued in excess of funds on deposit (2013 - \$36,671).

21. 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 (2013 - \$100,000) related to its bank line of credit (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 long-term debt, finance lease obligations and shareholders' equity as capital, which consists of the following:

	<u>2014</u>	<u>2013</u>
Long-term debt (Note 11)	\$ 915,197	\$ 1,034,835
Finance lease obligations (Note 12)	53,703	100,460
Shareholders' equity	4,378,185	3,644,760
	<u>\$ 5,347,085</u>	<u>\$ 4,780,055</u>

22. MAJOR CUSTOMER

During the year ended June 30, 2014, the Company had sales of \$4,801,625 (2013 - \$3,920,450) to the Manitoba Liquor and Lotteries Commission which accounted for 51% of its gross revenues (2013 - 45%).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

(Expressed in Canadian Dollars)

23. CONTINGENT LIABILITIES

- (a) A claim was made against the Company from a company controlled by a former director of the Company in relation to legal services provided over the last two years and services provided pursuant to the purported Legal Services Agreement dated April 1, 2013 in the amount of \$62,961. In addition, a severance claim has been made amounting to six months' payments under the purported Legal Services Agreement. The Company believes it has a good defense to the claim and no amount has been accrued for settlement.
- (b) A claim was made against the Company by the former CEO and director of the Company in relation to company expenses incurred from September 2012 in the amount of \$16,652 including interest.

24. EMPLOYEE BENEFITS

During the year ended June 30, 2014, the Company incurred \$2,103,463 in employee benefits (2013 - \$1,715,922) of which \$1,207,366 (2013 - 876,253) is included in selling, general and administrative expense and \$896,097 (2013 - \$839,669) is included in cost of sales.

25. SUBSEQUENT EVENTS

- (a) On July 9, 2014, the Company, pursuant to its stock option plan, granted an aggregate of 4,550,000 options to certain directors, officers, and employees of the Company. The options have an exercise price of \$0.07 per share and will vest according to schedules set by the Board of Directors of the Company. The options are exercisable for a period of five years.
- (b) On September 5, 2014, Pursuant to the bridge loan agreement entered into on September 3, 2013, the Company repaid in full, the principal of \$100,000 and interest totaling \$9,202 (see Note 18(h)).