RUSSELL BREWERIES INC.

CONDENSED CONSOLIDATED INTERIM
FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2014 AND 2013

UNAUDITED

**NOTICE OF NO AUDITOR REVIEW OF CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

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

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

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

**RUSSELL BREWERIES INC.**

**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION**

**(Unaudited; Expressed in Canadian Dollars)**

| | | September 30, 2014 | | June 30, 2014 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Current** | | | | |
| Cash and cash equivalents | $ | **334,220** | $ | 662,056 |
| Accounts receivable | | **602,825** | | 833,078 |
| Inventories (Note 4) | | **884,277** | | 867,530 |
| Prepaid expenses and deposits | | **189,852** | | 200,710 |
| | | **2,011,174** | | 2,563,374 |
| PROPERTY AND EQUIPMENT (Note 5) | | **2,570,474** | | 2,573,345 |
| INTANGIBLE ASSETS (Note 6) | | **1,935,268** | | 1,935,268 |
| RESTRICTED TERM DEPOSITS (Note 7) | | **100,000** | | 100,000 |
| LONG-TERM INVESTMENT (Note 9) | | **100,000** | | 100,000 |
| | $ | **6,716,916** | $ | 7,271,987 |
| **LIABILITIES** | | | | |
| **Current** | | | | |
| Bank indebtedness [Note 19(c)] | $ | **–** | $ | 36,966 |
| Accounts payable and accrued liabilities | | **620,750** | | 810,713 |
| Income taxes payable | | **171,000** | | 171,000 |
| Due to related parties (Note 17) | | **75,770** | | 215,100 |
| Current portion of long-term debt (Note 10) | | **254,313** | | 286,417 |
| Current portion of finance lease obligations (Note 11) | | **23,875** | | 27,052 |
| | | **1,145,708** | | 1,547,248 |
| LONG-TERM DEBT (Note 10) | | **511,663** | | 565,653 |
| FINANCE LEASE OBLIGATIONS (Note 11) | | **21,494** | | 26,651 |
| UNEARNED LICENSE FEES (Note 12) | | **50,000** | | 56,250 |
| DEFERRED TAX LIABILITIES | | **698,000** | | 698,000 |
| | | **2,426,865** | | 2,893,802 |
| **SHAREHOLDERS' EQUITY** | | | | |
| SHARE CAPITAL (Note 13) | | **12,282,587** | | 12,283,087 |
| SHARE-BASED PAYMENTS RESERVES | | **3,614,036** | | 3,570,648 |
| DEFICIT | | **(11,606,572)** | | (11,475,550) |
| | | **4,290,051** | | 4,378,185 |
| | $ | **6,716,916** | $ | 7,271,987 |

COMMITMENTS AND CONTINGENCIES (Note 19)

Approved and authorized for issuance on behalf of the Board of Directors on November 27, 2014:

*/s/ Benjamin Li Yu*
Benjamin Li Yu, Director

*/s/ Peter H. Stafford*
Peter H. Stafford, Director

**RUSSELL BREWERIES INC.**

**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**(Unaudited; Expressed in Canadian Dollars)**

| | | Three Months Ended September 30, 2014 | Three Months Ended September 30, 2013 |
|---|---|---|---|
| GROSS REVENUES (Note 21) | $ | **2,475,006** | 2,477,287 |
| LESS: EXCISE TAX AND PROVINCIAL MARK-UP | | **472,364** | 536,817 |
| NET REVENUES | | **2,002,642** | 1,940,470 |
| COST OF SALES (Note 4) | | **1,023,242** | 781,941 |
| GROSS MARGIN | | **979,400** | 1,158,529 |
| EXPENSES | | | |
| Depreciation | | **29,240** | 25,486 |
| Selling, general and administrative | | **1,048,671** | 995,078 |
| | | **1,077,911** | 1,020,564 |
| EARNINGS (LOSS) BEFORE OTHER INCOME | | **(98,511)** | 137,965 |
| OTHER INCOME (EXPENSE) | | | |
| Interest on finance lease obligations | | **(4,645)** | (5,236) |
| Interest on long-term debt | | **(34,686)** | (45,299) |
| Interest income | | **–** | 54 |
| Other income (Note 12) | | **6,820** | 6,250 |
| | | **(32,511)** | (44,231) |
| INCOME (LOSS) BEFORE INCOME TAXES | | **(131,022)** | 93,734 |
| INCOME TAXES | | | |
| Deferred income tax expense | | **–** | – |
| NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) FOR THE PERIOD | | **(131,022)** | 93,734 |
| EARNINGS (LOSS) PER SHARE (Note 15) | | | |
| Basic and diluted | $ | **(0.00)** | 0.00 |

**RUSSELL BREWERIES INC.**

**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY**

(**Unaudited; Expressed in Canadian Dollars**)

| | Share Capital | | | | |
|---|---|---|---|---|---|
| | Number of Shares | Value | Share-based payments reserves | Deficit | Total Shareholders' Equity |
| **Balance, June 30, 2014** | **87,083,788** | **$12,283,087** | **$3,570,648** | **$(11,475,550)** | **$4,378,185** |
| **Comprehensive loss for the period** | **–** | **–** | **–** | **(131,022)** | **(131,022)** |
| **Share issuance cost** | **–** | **(500)** | **–** | **–** | **(500)** |
| **Fair value of stock options granted** | **–** | **–** | **43,387** | **–** | **43,387** |
| **Balance, September 30, 2014** | **87,083,788** | **$12,282,587** | **$3,614,035** | **$(11,606,572)** | **$4,290,050** |

| | Share Capital | | | | |
|---|---|---|---|---|---|
| | Number of Shares | Value | Share-based payments reserves | Deficit | Total Shareholders' Equity |
| **Balance, June 1, 2013** | 78,350,455 | $11,783,304 | $3,398,726 | $(11,537,270) | $3,644,760 |
| **Comprehensive income for the period** | – | – | – | 93,734 | 93,734 |
| **Share issuance cost** | – | (600) | – | – | (600) |
| **Dividends on preferred shares** | – | – | 34,391 | – | 34,391 |
| **Balance, September 30, 2013** | 78,350,455 | $11,782,704 | $3,433,117 | $(11,443,536) | $3,772,285 |

**RUSSELL BREWERIES INC.**

**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS**

**(Unaudited; Expressed in Canadian Dollars)**

| | Three Months Ended September 30, 2014 | Three Months Ended September 30, 2013 |
|---|---|---|
| **CASH FLOWS PROVIDED BY (USED IN):** | | |
| **OPERATING ACTIVITIES** | | |
| Net income (loss) for the period | **$ (131,022)** | $ 93,734 |
| Adjusted for non-cash items: | | |
| Depreciation | **124,259** | 101,230 |
| Accretion of long-term debt | **20,895** | 2,539 |
| Accrued interest on long-term debt | **(3,594)** | – |
| Accretion of convertible debentures | **–** | 1,620 |
| Recognition of unearned license fee (Note 12) | **(6,250)** | (6,250) |
| Share-based compensation (Note 13) | **43,387** | 34,391 |
| | **47,675** | 227,264 |
| Net changes in non-cash working capital items: | | |
| Accounts receivable | **230,254** | 194,600 |
| Prepaid expenses and deposits | **10,858** | (1,520) |
| Inventories | **(16,747)** | 30,031 |
| Due to and from related parties | **(24,000)** | 97,392 |
| Accounts payable and accrued liabilities | **(189,963)** | (230,371) |
| | **58,077** | 317,396 |
| **INVESTING ACTIVITIES** | | |
| Purchases of property and equipment | **(121,388)** | (11,259) |
| | **(121,388)** | (11,259) |
| **FINANCING ACTIVITIES** | | |
| Repayment of demand loan | **(100,000)** | – |
| Share issuance cost | **(500)** | (2,220) |
| Repayment of bank indebtedness | **(36,966)** | (36,671) |
| Repayment of long-term debt | **(118,724)** | (250,457) |
| Repayment of finance lease obligations | **(8,334)** | (9,249) |
| | **(264,524)** | (298,597) |
| **INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | **(327,835)** | 7,540 |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD** | **662,055** | 213,452 |
| **CASH AND CASH EQUIVALENTS, END OF PERIOD** | **$ 334,220** | $ 220,992 |
| CASH AND CASH EQUIVALENTS CONSIST OF: | | |
| Demand deposits | **$ 334,220** | $ 220,992 |

SUPPLEMENTAL CASH FLOW INFORMATION (Note 16)

## 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 have been prepared on the basis of accounting principles applicable to a going concern, which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. As at September 30, 2014, the Company had a positive working capital of $865,466 and accumulated losses since inception of $11,606,572. The continued operation of the Company is dependent on its ability to obtain financing sufficient to generate profitable operations in the future. There is no guarantee that the Company will be able to raise this additional financing.

## 2. STATEMENT OF COMPLIANCE AND BASIS OF PRESENTATION

### a) Statement of Compliance

These unaudited condensed interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB"). The unaudited condensed interim financial statements do not include all of the information required for full annual financial statements. These interim consolidated financial statements should be read in conjunction with the Company's June 30, 2014 annual audited consolidated financial statements.

The condensed consolidated interim financial statements were authorized for issuance by the Board of Directors on November 27, 2014.

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

These unaudited condensed interim financial statements include the accounts of Russell Breweries Inc. and its wholly owned subsidiaries Russell Brewing Company Ltd. ("Russell"), Fort Garry Brewing Company Ltd. ("Fort Garry") and Russell USA LLC. The following companies have been consolidated with Russell Breweries Inc. as at September 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 Garry Brewing Company Ltd. | Manitoba | 100% | Canadian Dollar |
| Russell USA LLC | United States | 100% | United States Dollar |

Inter-company balances and transactions, and any unrealized gains arising from inter-company transactions, are eliminated in preparing the condensed consolidated interim 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.

(Unaudited; Expressed in Canadian Dollars)

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

### d) Significant Accounting Estimates and Judgments

The preparation of these condensed 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 may include recovery of accounts receivable, inventory valuation, the estimated useful life of long-lived assets, assessment of long-term investment, estimates used in impairment assessments of long-lived assets, valuation of deferred income tax assets and liabilities and estimates used in calculating share-based compensation. 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.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies that have been used in the preparation of these condensed interim financial statements are summarized in the audited consolidated financial statements of the Company for the year ended June 30, 2014. These statements should be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2014.

## 4. INVENTORIES AND COST OF SALES

| | | **September 30, 2014** | | June 30, 2014 |
|---|---|---|---|---|
| Finished goods | $ | **111,531** | $ | 118,273 |
| Work-in-progress | | **255,656** | | 259,503 |
| Raw materials | | **517,090** | | 489,754 |
| | $ | **884,277** | $ | 867,530 |

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

| | | Three Months Ended September 30, 2014 | | Three Months Ended September 30, 2013 |
|---|---|---|---|---|
| Inventories | **$** | **928,223** | $ | 706,197 |
| Depreciation | | **95,019** | | 75,744 |
| | **$** | **1,023,242** | $ | 781,941 |

(Unaudited; Expressed in Canadian Dollars)

## 5. PROPERTY AND EQUIPMENT

| | Computer | Equipment | Leasehold improvements | Office furniture and fixtures | Vehicles | Returnable containers | Total |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| Balance as at 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 |
| **Additions** | – | **20,829** | 45,966 | – | – | 54,593 | 121,388 |
| **Balance as at September 30, 2014** | **$ 77,401** | **$ 6,054,721** | **$ 1,388,942** | **$ 63,844** | **$ 552,729** | **$ 962,355** | **$ 9,099,992** |
| **Accumulated Depreciation** | | | | | | | |
| 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 |
| **Depreciation** | 507 | 85,269 | 4,597 | – | 13,488 | 20,398 | 124,259 |
| **Balance as at September 30, 2014** | **$ 70,211** | **$ 3,726,639** | **$ 1,314,433** | **$ 63,844** | **$ 472,473** | **$ 881,918** | **$ 6,529,518** |
| **Carrying amounts** | | | | | | | |
| 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 |
| **September 30, 2014** | **$ 7,189** | **$ 2,328,082** | **$ 74,510** | **$ –** | **$ 80,256** | **$ 80,437** | **$ 2,570,474** |

Equipment includes assets under finance leases with a cost of $439,719 (June 30, 2014 – $439,719) and accumulated depreciation of $103,998 (June 30, 2014 – $99,159). Vehicles includes assets under finance leases with a cost of $537,508 (June 30, 2014 – $537,509) and accumulated depreciation of $430,311 (June 30, 2013 – $416,873).

(Unaudited; Expressed in Canadian Dollars)

## 6. INTANGIBLE ASSETS

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

## 7. RESTRICTED TERM DEPOSITS

A term deposit of $100,000 has been pledged as security for a $100,000 bank line of credit (June 30, 2014 – $100,000).

## 8. BRIDGE LOAN DUE TO RELATED PARTIES

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.

## 9. 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 12). As of September 30, 2014, the Company’s interest in the Licensee has decreased to 7.69%.

(Unaudited; Expressed in Canadian Dollars)

## 10. LONG-TERM DEBT

| | September 30, 2014 | June 30, 2014 |
|---|---|---|
| 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 $9,750 plus interest maturing November 15, 2014, secured by the assets of Fort Garry (a) | **$ 17,287** | $ 48,750 |
| 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) | **20,359** | 22,896 |
| Term loan, bearing interest at 10% per annum calculated semi-annually, repayable in monthly installments of $17,500 plus interest maturing on July 31, 2016, secured by the assets of Russell and Fort Garry (c) | **392,667** | 444,121 |
| Term loan due to related parties, bearing interest at 9% per annum calculated semi-annually, secured by a guarantee by a director of the Company, due December 31, 2015 (d) | **335,662** | 336,303 |
| | **765,975** | 852,070 |
| Less: current portion of long-term debt | **(254,313)** | (286,417) |
| Long-term portion of long-term debt | **$ 511,663** | $ 565,653 |

(a) On December 8, 2008, the bank made an amendment to the existing term loan in accordance with the request of the Company for a six month principal postponement. Pursuant to the amendment, the remaining loan amount on December 8, 2008 of $787,500 was to be repaid by 42 consecutive monthly principal installments of $18,750 each commencing June 15, 2009 and ending November 15, 2012. The bank also granted a reduction of the interest rate on the term loan by 1%. With the exception of the amendments agreed, all terms and conditions of the term loan remain unchanged. On September 22, 2010, the bank made a further amendment to the existing term loan in accordance with the request of the Company. Pursuant to the amendment, the remaining loan amount is to be repaid by 50 consecutive monthly principal installments of $9,750 each commencing October 15, 2010 and ending November 15, 2014.

(b) On October 5, 2010, the Company's subsidiary Fort Garry Brewing Company Ltd. accepted an offer of a $100,000 pre-authorized working capital loan from Business Development Bank of Canada ("BDC"). The BDC Loan, bearing interest at floating base rate plus a variance of 1% maturing August 15, 2015, is secured by the assets of Fort Garry and supported by a guarantee made by two directors of the Company. In return for the guarantee, the Company issued 250,000 common shares of the Company as bonus shares with an estimated fair value of $0.08 per share for a total value of $20,000, which was recorded as a financing cost against the value allocated to the loan. During the period ended September 30, 2014, the Company recorded interest expense of $500 (2013 - $919) 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.

**10. LONG-TERM DEBT** (continued)

(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 provides to the Company a new loan valued at maturity in the amount of $738,600. A discounted value or loan advance amount of $620,000 is calculated based on a 10% per annum interest rate, calculated semi-annually, with interest payable on maturity resulting in a total loan value at maturity of $738,600. In consideration of the lender agreeing to amend and extend the loan, the lender will also earn a bonus of $22,500 to be included in the loan amount. The term of the loan is nineteen months. The Company may repay the loan at any time without penalty by paying the discounted loan advance amount of $620,000 together with accumulated interest.

On July 11, 2012, the Company agreed to a one-year extension 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 September 30, 2014 was $392,667 (2013 - $444,121).

(Unaudited; Expressed in Canadian Dollars)

**10. LONG-TERM DEBT** (continued)

(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 10(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 period ended September 30, 2014, the Company recorded interest expense of $2,713 (2013 - $6,597) 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 13(c)). 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.

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

| Fiscal Year | | **Amount** |
|---|---|---|
| 2015 | **$** | **192,750** |
| 2016 | | **713,500** |
| 2017 | | **17,500** |
| | **$** | **923,750** |

(Unaudited; Expressed in Canadian Dollars)

## 11. 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:

| Fiscal Year: | | **Amount** |
|---|---|---|
| 2015 | **$** | **25,837** |
| 2016 | | **27,483** |
| Total minimum lease payments | | **53,320** |
| Less: amount representing interest | | **(7,951)** |
| Net minimum lease payments | | **45,369** |
| Less: current portion of finance lease obligations | | **(23,875)** |
| Long-term portion of finance lease obligations | **$** | **21,494** |

## 12. UNEARNED LICENSE FEES

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

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

During the period ended September 30, 2014, the Company has recognized $569 (2013 - $nil) in royalties and $6,250 (2013 - $6,250) in license fees earned under the agreement, which has been recorded as other income in the statement of operations. As at September 30, 2014, the unearned license fee is $50,000.

## 13. SHARE CAPITAL

### (a) Authorized Share Capital

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

### (b) Stock Options

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

(Unaudited; Expressed in Canadian Dollars)

## 13. SHARE CAPITAL (continued)

### (b) Stock Options (continued)

During the period ended September 30, 2014, the Company granted 4,550,000 and vested 618,743 (2013 – granted nil and vested 83,333) net of forfeited incentive stock options to key employees and directors exercisable at $0.07 per share expiring after five years of the grant date, pursuant to its stock option plan. The fair value of each option granted was $0.07 calculated using the Black-Scholes option-pricing model at the date of grant using the following assumptions: expected option life for 3.48 years; forfeiture rate of 0%~12.9%; risk-free interest rate of 1.47%; expected dividend yield of 0% and expected stock price volatility of 205%. During the period ended September 30, 2014, the Company recorded a total amount of $43,387 (2013 – $34,392) compensation cost included in selling, general and administrative expense relating to these options.

Stock option activity during the period ended September 30, 2014 and the year ended June 30, 2014 is presented below:

| | **September 30, 2014** | | | June 30, 2014 | | |
|---|---|---|---|---|---|---|
| | **Number of Shares** | | **Weighted Average Exercise Price** | Number of Shares | | Weighted Average Exercise Price |
| Outstanding, beginning of period | **50,000** | **$** | **0.10** | 1,300,000 | $ | 0.10 |
| Granted | **4,550,000** | | **0.07** | – | | – |
| Forfeited | **–** | | **–** | (1,250,000) | | 0.10 |
| Outstanding, end of period | **4,600,000** | **$** | **0.07** | 50,000 | $ | 0.10 |

At September 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** | **2.50** | **0.10** | **50,000** | **0.10** |
| **0.07** | **4,550,000** | **4.78** | **0.07** | **568,743** | **0.07** |
| | **4,600,000** | **4.75** | **0.07** | **618,743** | **0.07** |

(Unaudited; Expressed in Canadian Dollars)

## 13. SHARE CAPITAL (continued)

### (c) Warrants

Warrant activity during the period ended September 30, 2014 and the year ended June 30, 2014 is presented below:

| | **September 30, 2014** | | June 30, 2014 | |
|---|---|---|---|---|
| | **Number of Shares** | **Weighted Average Exercise Price** | Number of Shares | Weighted Average Exercise Price |
| Outstanding, beginning of period | **13,640,000** | **$ 0.09** | 9,640,000 | $ 0.10 |
| Granted | **–** | **–** | 4,000,000 | 0.05 |
| Outstanding, end of period | **13,640,000** | **$ 0.09** | 13,640,000 | $ 0.09 |

At September 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** | |

## 14. INCOME TAXES

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:

| Fiscal Year of Expiry | **Amount** |
|---|---|
| 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** |
| | **$ 11,654,000** |

(Unaudited; Expressed in Canadian Dollars)

## 15. EARNINGS (LOSS) PER SHARE

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

| | **Three Months Ended September 30, 2014** | Three Months Ended September 30, 2013 |
|---|---|---|
| Net earnings (loss) and comprehensive earnings (loss) | **$ (131,022)** | $ 93,734 |
| Net earnings (loss) attributable to common shareholders | **$ (131,022)** | $ 93,734 |

The weighted average number of shares outstanding used in the computation of earnings (loss) per share for the period ended September 30, 2014 was 87,083,788 (June 30, 2014 – 79,639,085). Outstanding stock options, warrants, and agent unit options have not been considered in the computation of diluted earnings (loss) per share as the result is anti-dilutive.

## 16. SUPPLEMENTAL CASH FLOW INFORMATION

| | **Three Months Ended September 30, 2014** | Three Months Ended September 30, 2013 |
|---|---|---|
| Cash paid for: | | |
| Interest | **$ 6,025** | $ 46,376 |
| Non-cash investing and financing activities: | | |
| Common shares issued for convertible debentures | **$ –** | $ 1,620 |

## 17. 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:

| | **Three Months Ended September 30, 2014** | Three Months Ended September 30, 2013 |
|---|---|---|
| Short-term benefits: | | |
| Salaries, management & consulting fees [Notes 17(a)] | **$ 224,026** | $ 96,165 |
| Directors fees [Note 17(b)] | **9,000** | 9,484 |
| Share-based payments [Note 13(b)] | **43,387** | 34,391 |
| Total short-term benefits: | **$ 276,413** | **$ 140,040** |

## 17. RELATED PARTY TRANSACTIONS AND BALANCES (continued)

(a) During the period ended September 30, 2014, the Company incurred management fees and salaries totaling $224,026 to a company controlled by the CEO and other key management personnel (2013 – $96,165). As at September 30, 2014, the Company owed $19,937 to the CEO and a company controlled by the CEO (2013 – $9,958), which is non-interest bearing, unsecured and due on demand.

(b) During the period ended September 30, 2014, the Company granted 4,550,000 (2013 - nil) stock options to directors and officers and key employees and incurred director fees of $9,000 to the directors of the Company (2013 – $9,484). As at September 30, 2014, the Company owed $nil to the independent directors (2013 – $35,602), which is non-interest bearing, unsecured and due on demand.

(c) During the period ended September 30, 2014, the Company repaid in full, the principal of $100,000 and interest totaling $9,202 to spouses of certain directors pursuant to a bridge loan agreement entered on September 3, 2013.

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.

## 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, 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 September 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.

(Unaudited; Expressed in Canadian Dollars)

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

### (b) Fair Value Measurements (continued)

Level 3 - Significant Unobservable Inputs
Unobservable (supported by little or no market activity) inputs.

Financial assets and liabilities measured at fair value on a recurring basis were presented on the Company's September 30, 2014 consolidated interim 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 September 30, 2014 $** |
| Assets: | | | | |
| Cash and cash equivalents | 334,220 | – | – | 334,220 |
| Restricted term deposits | 100,000 | – | – | 100,000 |

### (c) Financial Risks

#### (i) Credit Risk

Credit risk arises from the non-performance by counterparties of contractual financial obligations. The Company maintains substantially all of its cash and cash equivalents and restricted term deposits with major financial institutions. Deposits held with these institutions may exceed the amount of insurance provided on such deposits. As at September 30, 2014, the Company has significant accounts receivable from one major customer totaling $369,359 (June 30, 2014 - $335,502). The Company manages credit risk for trade and other receivables through established credit monitoring activities. As at September 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:

| | **September 30, 2014** | | June 30, 2014 | |
|---|---|---|---|---|
| | **Over 90 days** | **Total** | Over 90 days | Total |
| Provincial Liquor Boards | **$ 3,371** | **$ 620,077** | $ – | $ 741,080 |
| Other Receivables | | | – | 91,198 |
| Total | **$ 3,371** | **$ 620,077** | $ – | $ 833,078 |

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 with government agencies. While substantially all of the Company's accounts receivable are from provincial government liquor authorities, the timing of receipts of large balances may vary significantly from period to period.

(Unaudited; Expressed in Canadian Dollars)

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

### (c) Financial Risks (continued)

#### (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 September 30, 2014 are as follows:

| | **Less Than 1 Year $** | Years 2 and 3 $ | Years 4 and 5 $ | More Than 5 Years $ | Total $ |
|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | **620,750** | – | – | – | 620,750 |
| Long-term debt (Note 10) | **192,750** | 731,000 | – | – | 923,750 |
| Finance lease obligations (Note 11) | **23,875** | 21,494 | – | – | 45,369 |
| | **837,375** | 752,494 | – | – | 1,589,869 |

As at September 30, 2014, the Company had a positive working capital of $865,466.

#### (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.

## 19. COMMITMENTS AND CONTINGENCIES

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

| Fiscal Year | **Amount** |
|---|---|
| 2015 | **$ 408,885** |
| 2016 | **434,281** |
| 2017 | **327,938** |
| 2018 | **327,938** |
| 2019 | **331,316** |
| | **$ 1,830,358** |

(Unaudited; Expressed in Canadian Dollars)

## 19. COMMITMENTS AND CONTINGENCIES (continued)

(b) At September 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 7).

## 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 (June 30, 2013 - $100,000) related to its bank line of credit (see Note 7). There are no other externally imposed capital requirements.

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

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

| | | **September 30, 2014** | | June 30, 2014 |
|---|---|---|---|---|
| Long-term debt (Note 10) | **$** | **765,976** | $ | 852,070 |
| Finance lease obligations (Note 11) | | **45,369** | | 53,703 |
| Shareholders' equity | | **4,290,051** | | 4,378,185 |
| | **$** | **5,101,396** | $ | 5,283,958 |

## 21. MAJOR CUSTOMER

During the period ended September 30, 2014, the Company had sales of $1,307,563 (2013 - $1,265,261) to the Manitoba Liquor Control Commission which accounted for 53% of its gross revenues (2013 - 54%).

## 22. 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.