

**RUSSELL BREWERIES INC.**  
**Management's Discussion and Analysis**  
**For the three months ended September 30, 2014**

This Management's Discussion and Analysis ("MD&A") of Russell Breweries Inc. dated November 27, 2014 provides an analysis of Russell's results of operation and financial condition for the three months ended September 30, 2014. This MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements, and accompanying notes for the three months ended September 30, 2014 and with the audited consolidated financial statements and accompanying notes for the years ended June 30, 2014 and 2013. Additional information related to Russell Breweries Inc. is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.russellbeer.com](http://www.russellbeer.com).

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

This MD&A was approved and authorized for issuance by the Board of Directors on November 27, 2014.

## **FORWARD LOOKING STATEMENTS**

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

## **OVERVIEW**

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

## **BUSINESS DEVELOPMENTS AND SIGNIFICANT EVENTS**

On August 8, 2013, Mr. Peter H. Stafford and Mr. Richard Ruijian Shi were appointed to the board of directors of the Company. Effective September 1, 2013, Mr. Brian Harris retired as Chief Executive Officer ("CEO") of the Company. Mr. Benjamin Li Yu will act as interim CEO until a suitable and permanent replacement is found.

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

On September 15, 2013, the Company released the Russell Marzen – Oktoberfest Lager in 650ml bottles, a seasonal limited release as part of the Russell Brewmaster Series.

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

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

On January 20, 2014, the Company entered into a loan agreement with Weichun Ye and Yan Zeng (the Lenders) and Dongbing (Derrick) Ma (the Guarantor), whereby the Lenders will loan to the Company an aggregate principal amount of \$500,000. The Company's obligations under the loan agreement are guaranteed by the Guarantor. (see LIQUIDITY AND CAPITAL RESOURCES: Financing).

On March 18, 2014, the Company introduced Russell Eastern Promises Czech Pilsner and A Wee Angry Scotch Ale in 341ml bottle 6-packs, in addition to 650ml bottles.

On March 20, 2014, the Company announced a non-brokered private placement of common shares of the Company of up to \$500,000 at the price of \$0.06 per Share.

On May 1, 2014, the Company released the Russell White Rabbit Hopped Hefeweizen in 650ml bottles, a new seasonal limited release as part of the Russell Seasonal Series.

On May 7, 2014, the Company announced that it has completed the first tranche of its non-brokered private placement of common shares of the Company as previously announced on March 20, 2014. Under the private placement, the Company issued and sold 7,083,333 shares for aggregate gross proceeds of \$425,000.

On May 23, 2014, the Company released the Russell Hop Therapy India Session Ale in 350ml cans, a new product as part of the Russell Brewmaster Series.

On May 31, 2014, the Company won three medals at the 12th annual Canadian Brewing Awards: a gold medal for Wee Angry Scotch Ale in the Scotch Ale category, a bronze medal for IPeH! in the English Style India Pale Ale category and a bronze medal for Smokey the Beer in the experimental beer category. The Canadian Brewing Awards is an annual beer competition that invites breweries of all sizes from across the country to compete in a blind tasting by a panel of Certified Beer Judges (BJCP). This year, the Awards were held at the convention centre in Fredericton, New Brunswick. There were 916 beers in 38 categories entered into this year's competition from over 130 Canadian breweries.

On June 18, 2014, the Company announced that it has completed the final tranche of its non-brokered private placement of common shares of the Company as previously announced on March 20, 2014. Under the final tranche of the private placement, the Company issued and sold 1,250,000 Shares for gross proceeds of \$75,000.

On July 9, 2014, the Company announced that pursuant to its stock option plan, the Company has granted an aggregate of 4,550,000 options (the 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.

On September 5, 2014, pursuant to the bridge loan agreement entered on September 3, 2013, the Company repaid in full, the principal of \$100,000 and interest totalling \$9,203.

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

Categories	Brands
Super Premium	Russell Nectar of the Gods Wheat Wine Ale, Fort Garry Kona Imperial Stout, Russell Hop Therapy ISA, Russell Hop Therapy Double IPA, Russell Truth Serum Wheat Wine Ale
Premium	Eastern Promises, Russell IP'eh!, Black Death Porter, Russell Marzen, A Wee Angry Scotch Ale, Blood Alley Bitter, Fort Garry Munich Eisbock, Fort Garry Portage and Main IPA, Fort Garry Big Bison
Session	Russell Cream Ale, Russell Pale Ale, Russell Extra Special Lager, Fort Garry Dark, Fort Garry Pale, Fort Garry Rouge, Fort Garry Premium Light, Fort Garry Lime Lager
Value	Fort Garry Rocky Mountain Pilsner, Fort Garry Stone Cold Lager, Fort Garry Two Rivers Lager
Seasonal	Russell White Rabbit, Russell lemon Ale, Russell Summer Daze, Russell Naughty & Spiced Porter, Russell Luck of the Irish, Russell Smokey The Beer, Fort Garry St. Nick's Porter
Partnership	Nautical Disaster Barley Wine, Capilano Rugby Pilsner, Pemberton Pilsner, GUUUD Ale, Cactus IPA, Angry Fish Pilsner,

**SELECTED INFORMATION**

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

Selected Information	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012
	\$	\$	\$
<b>Statement of Comprehensive Loss Data</b>			
Gross Revenue	2,475,006	2,477,287	2,325,082
Net Revenues (after excise tax and provincial mark-up)	2,002,642	1,940,470	1,806,789
Earnings before interest and other income, taxes, depreciation and amortization (EBITDA)	25,748	239,195	147,646
Total income (loss) from continuing operations	(131,022)	93,734	(63,408)
Operating income (loss) per share	(0.00)	0.00	(0.00)
Net income (loss) and comprehensive income (loss)	(131,022)	93,734	(63,408)
Basic and diluted earnings (loss) per share	(0.00)	0.00	(0.00)
<b>Statement of Financial Position Data</b>			
Total assets	6,716,916	6,843,459	7,065,294
Total long term financial liabilities	533,157	256,410	246,310
Cash dividends declared per share	Nil	Nil	Nil

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**PERFORMANCE AND RESULTS OF OPERATIONS**

***Three Months Ended September 30, 2014 ("Q1 2015F" and "2015F YTD")***

The Company had a net loss and comprehensive loss of \$131,022 for the period ended September 30, 2014 ("Q1 2015F") compared to net income and comprehensive income of \$93,734 for the period ended September 30, 2013 ("Q1 2014F"). The increase in net loss is primarily due to the decrease in gross margin of \$179,128 and increase in selling, general and administrative expenses of \$53,593.

Gross revenue for Q1 2015F were \$2,475,006 down \$2,281 or 0% compared to \$2,477,287 for Q1 2014F. Net sales for Q1 2015F were \$2,002,642 up \$62,172 or 3% compared to \$1,940,470 for Q1 2014F.

The gross margin for Q1 2015F decreased by \$179,128 or 15% to \$979,400 compared to \$1,158,528 for Q1 2014F. The gross margin percentage of Q1 2015F was down 11% to 49% compared to 60% for Q1 2014F. The decrease in gross margin percentage is mainly due to increase in the cost of packaging materials from the shift to higher percentage of revenue in packaged beers compared to draft beers, increased in labour cost due to salary increase and bonus, higher depreciation cost from new equipment and production loss from the research and development of new brew flavours .

Selling, general and administration expenses for Q1 2015F were at \$1,048,671 up \$53,593 or 5% compared to \$995,078 for Q1 2014F. This is primarily due to the following reasons:

- i. Labour cost increased by \$50,063 to \$307,949 from \$257,886 due to annual salary increase, bonus and higher headcount in the sales department.
- ii. Advertising and promotion increased by \$69,105 to \$290,508 from \$221,403 due to higher selling, marketing and promotional spending for this period.
- iii. Management fees increased by \$39,934 to \$75,417 from \$35,483.
- iv. Share-based compensation increased by \$8,996 to \$43,387 from \$34,391 due to new option grants for this period.

Offset by the following:

- i. Professional fees decreased by \$122,612 to \$45,067 from \$167,679 mainly due to lower accounting fees as a result of the resignation of the previous CFO.

Other expenses for Q1 2015F were down \$11,719 to \$32,512 from \$44,231 for Q1 2014F mainly due to lower interest expense on long-term debt.

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**Summary of Quarterly Results**

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

<b>Fiscal Year Quarter</b>	<b>2015F Q1</b>	<b>2014F Q4</b>	<b>2014F Q3</b>	<b>2014F Q2</b>	<b>2014F Q1</b>	<b>2013F Q4</b>	<b>2013F Q3</b>	<b>2013F Q2</b>
(in \$000, except per share amounts)	\$	\$	\$	\$	\$	\$	\$	\$
Net revenues	2,003	1,980	1,654	1,972	1,940	1,875	1,540	1,511
SG&A <sup>(1)</sup>	1,049	1,058	784	960	995	1,005	823	910
EBITDA <sup>(2)</sup>	26	96	213	211	239	(136)	220	82
Net income (loss)	(131)	(187)	63	92	94	(468)	74	(88)
Net earnings (loss) per share	(0.00)	(0.00)	0.00	0.00	0.00	(0.01)	0.00	(0.00)

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

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

The Company has historically experienced a seasonal pattern in its operating results, with the second and third quarters historically exhibiting lower revenues. Net revenue for Q1 2015F were \$2,002,642 up by \$22,846 compared to \$1,979,796 for Q4 2014F. The increase in net revenue is mainly due to shift in sales mix to premium brands which command better pricing. Net loss for Q1 2015F was \$131,022 compared to net loss of \$186,543 for Q4 2014F. The decrease in net loss is mainly attributed to the tax expense in Q4 2014F. The results in any one quarter are not indicative of results in any other quarter, or for the year as a whole.

Other significant impacts on quarterly expense trends may be share-based compensation expense, labour and management fee which is included in selling, general and administrative expenses.

**LIQUIDITY AND CAPITAL RESOURCES**

**Financial Condition**

At September 30, 2014, the Company had a positive working capital of \$865,466. The Company has \$334,220 of cash and \$100,000 of restricted term deposits securing up to \$100,000 of bank indebtedness. Liabilities include \$620,750 of accounts payable and accrued liabilities, \$765,975 of long-term debt (Note 10 of the consolidated interim financial statements), and \$45,369 of finance lease obligations (Note 11 of the consolidated interim financial statements).

The Company has an operating line of credit, a bridge loan, three finance leases, two operating leases and four term loans. As at September 30, 2014 and the date of this MD&A, the Company is in compliance with all of the covenants.

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

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**Cash Flow**

***Three Months Ended September 30, 2014 ("2015F YTD")***

Cash provided by operating activities in 2015F YTD was \$58,077 compared to cash provided of \$317,396 in 2014F YTD. The decrease in cash provided of \$259,319 was primarily due to lower net income and increased in inventories.

Cash used in 2015F YTD for investing activities was \$121,388 for the purchase of property and equipment compared to \$11,259 in 2014F YTD.

During the period, the Company repaid \$100,000 in bridge loan, \$118,724 in long-term debts and \$8,334 in finance lease obligations compared to repayment of \$250,257 in long-term debt and \$9,249 in finance lease obligations in the same period of the previous fiscal year.

**Outstanding Share Data**

As at September 30, 2014, the Company had 87,083,788 common shares issued and outstanding. In addition, the Company had the following outstanding share data at the date of this MD&A:

<b>Outstanding Share Data</b>	<b>Number of Common Shares</b>	<b>Exercise Price per Common Share</b>	<b>Expiry Dates</b>
Issued and outstanding as at June 30, 2014	87,083,788	N/A	N/A
Stock options	50,000	\$0.10	March 9, 2017
Stock options	4,550,000	\$0.07	July 9, 2019
Warrants	9,640,000	\$0.10	May 17, 2015
Warrants	4,000,000	\$0.05	December 31, 2015
Fully Diluted as of the date of this MD&A	<u>105,323,788</u>	N/A	N/A

**Financing**

- (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.

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- (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.
- (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).

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- (d) On July 26, 2013, the Company negotiated to further amend and extend repayment of the balance of \$630,000 of the loan in (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) of the consolidated interim financial statements). 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.

**Contractual Obligations, Commitments**

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



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A summary of the Company's contractual obligations for the next five years are as follows (Note 18(c) (ii) of the consolidated interim financial statement):

	<b>Less Than 1 Year \$</b>	<b>Years 2 and 3 \$</b>	<b>Years 4 and 5 \$</b>	<b>More Than 5 Years \$</b>	<b>Total \$</b>
Accounts payable and accrued liabilities	<b>620,750</b>	—	—	—	620,750
Long-term debt	<b>192,750</b>	731,000	—	—	923,750
Finance lease obligations	<b>23,875</b>	21,494	—	—	45,369
	<b>837,375</b>	752,494	—	—	1,589,869

**RELATED PARTIES**

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

	<b>Three Months Ended September 30, 2014</b>	<b>Three Months Ended September 30, 2013</b>
Short-term benefits:		
Salaries, management & consulting fees (a)	<b>\$ 224,026</b>	\$ 96,165
Directors fees (b)	<b>9,000</b>	9,484
Share-based payments	<b>43,387</b>	34,391
Total short-term benefits:	<b>\$ 276,413</b>	<b>\$ 140,040</b>

(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.

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**CRITICAL ACCOUNTING ESTIMATES**

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

**Property, Plant and Equipment**

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

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

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

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

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**Intangible Assets**

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

**RISKS AND UNCERTAINTIES**

**Credit Risk**

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

**Competition**

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

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

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

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**Government Regulation**

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

**Trends in Consumer Preferences and Attitudes**

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

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

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

**Dependence on Key Personnel**

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

**Operating Hazards**

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

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**Trade Regulations**

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

**Proprietary Rights**

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

**Seasonal Nature of Business**

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

**Availability of financing**

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

**Commodity price risk**

The Company is exposed to commodity price risk with respect to agricultural and other raw materials used to produce the Company's products, including malted barley, hops, corn syrup, water, and packaging materials (including bottles, aluminium cans, cardboard and other paper products), where fluctuations in the market price or availability of these items could impact the Company's cash flow and production. The supply and price can be affected by a number of factors beyond management's control, including market demand, global events, frosts, droughts and other weather conditions, economic factors affecting growth decisions, plant diseases, and theft. To the extent any of the foregoing factors affect the prices of ingredients or packaging, the Company's results of operations could be materially and adversely impacted. To minimize the impact of this risk, the Company enters into contracts which secure supply and set pricing to manage the exposure to availability and pricing.