RUSSELL BREWERIES INC.
Management's Discussion and Analysis
For the six months ended December 31, 2015

This Management's Discussion and Analysis ("MD&A") of Russell Breweries Inc. dated February 29, 2016 provides an analysis of the Company's results of operation and financial condition for the six months ended December 31, 2015. This MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements, and accompanying notes for the six months ended December 31, 2015 and with the audited consolidated financial statements and accompanying notes for the years ended June 30, 2015 and 2014. Additional information related to Russell Breweries Inc. is available on SEDAR at www.sedar.com and on the Company's website at 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 February 29, 2016.

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 two 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.

On July 1, 2014, Russell Brewing Company Ltd. ("Russell") amalgamated with Fort Garry Brewing Company Ltd. The continuing amalgamated entity is Fort Garry Brewing Company Ltd.

BUSINESS DEVELOPMENTS AND SIGNIFICANT EVENTS

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.

On June 8, 2015, the Company won two medals at the 13th annual Canadian Brewing Awards: a gold medal for Punch Bowl in the American Style India Pale Ale category, and a bronze medal for Blood Alley in the English Style Pale Ale/Bitter category.

On June 26, 2015, Premier Diversified Holdings Inc. made an unsolicited offer to acquire 51% of the issued and outstanding common shares of the Company.

On June 30, 2015, the Company announced that, in response to the unsolicited offer by Premier Diversified Holdings Inc. on June 26, 2015, the Board of Directors of the Company adopted a shareholder rights plan (the Plan). The purpose of the Plan is to provide the Company with sufficient time to properly consider the bid and its impact on the Company, to encourage fair treatment of the shareholders of the Company in connection with any unsolicited take-over bid for the Company, and to develop, consider and pursue all alternatives and to assist in determining the alternative which is in the best interest of the Company. The Plan is not intended to deter this or any bid.

On July 3, 2015, the Company and its wholly-owned subsidiary, Fort Garry Brewing Company Ltd. (Fort Garry), have each entered into a loan agreement with the Business Development Bank of Canada (BDC) whereby BDC has agreed to advance to the Company and Fort Garry $788,000 and $250,000 respectively.

On July 9, 2015, the Company announced that its Board of Directors has unanimously recommended to its shareholders to reject the unfair partial offer of Premier Diversified Holdings Inc. (Premier) to acquire up to 51% of the outstanding common shares of Russell (the Partial Offer) on the basis that the Partial Offer is unfair, inadequate, coercive and opportunistic.

On July 20, 2015, Mr. Alnesh Mohan and Mr. Sanjeev Parsad were appointed to the board of directors and Mr. Richard Ruijian Shi resigned as a director of the Company.

On July 21, 2015, the Company and Premier Diversified Holdings Inc. reached an agreement with respect to Premier's formal takeover bid for up to 51% of the outstanding common shares of Russell. Under the agreement, Premier has agreed to withdraw the bid and not take any action to take up any Russell shares under the bid.

On Oct 1, 2015, pursuant to the loan agreement entered with Business Development Bank of Canada (BDC) on July 3, 2015, the Company finalized a loan of $788,000 which was used to repay in full the principal and interest of the two long-term debts (Note 9(b) and 9(c) of the condensed consolidated interim financial statements).

On February 3, 2016, pursuant to the loan agreement entered with Business Development Bank of Canada (BDC) on July 3, 2015, the Company finalized a loan of $250,000 which was used to purchase production equipment.

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, Russell North Star Stout, Russell Punch Bowl, 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 years indicated below:

Selected Information	**Six Months Ended December 31, 2015**	**Six Months Ended December 31, 2014**	**Six Months Ended December 31, 2013**
	$	$	$
Statement of Comprehensive Loss Data			
Net Revenues (after excise tax and provincial mark-up)	4,226,373	3,993,939	3,912,060
Earnings before interest and other income, taxes, depreciation and amortization (EBITDA) (1)	274,709	327,700	450,108
Adjusted EBITDA(2)	323,751	403,470	470,034
Total income (loss) from continuing operations	(11,033)	48,702	185,617
Operating income (loss) per share	(0.00)	0.00	0.00
Net income (loss) and comprehensive income (loss)	(11,033)	48,702	185,617
Basic and diluted earnings (loss) per share	(0.00)	0.00	0.00
Statement of Financial Position Data			
Total assets	7,990,700	7,063,321	6,715,038
Total long term financial liabilities	665,000	470,165	279,545
Cash dividends declared per share	Nil	Nil	Nil

(1) 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.

(2) Adjusted EBITDA represents EBITDA excluding changes in stock based compensations and other non-recurring items:

Selected Information	Six Months Ended December 31, 2015	Six Months Ended December 31, 2014	Six Months Ended December 31, 2013
	$	$	$
EBITDA	274,709	327,700	450,108
Add: Stock-based compensation expense	47,479	78,679	(1,193)
Add (Less): Changes in refundable container expense (recovery)	1,563	(2,909)	21,119
Adjusted EBITDA	**323,751**	**403,470**	**470,034**

PERFORMANCE AND RESULTS OF OPERATIONS

Three Months Ended December 31, 2015 ("Q2 2016F")

The Company had a net income and comprehensive income of $38,712 for Q2 2016F compared to net income and comprehensive income of $179,725 for the three months ended December 31, 2014 ("Q2 2015F"). The decrease in net income and comprehensive income is primarily due to the increase in selling, general and administrative expenses of $213,162 offset by the increase in gross margin of $82,098.

Net revenue for Q2 2016F were $2,155,980 up $164,683 or 8% compared to $1,991,297 for Q2 2015F mainly due to higher sales.

The gross margin for Q2 2016F increased by $82,098 or 7% to $1,198,378 compared to $1,116,280 for Q2 2015F. The gross margin percentage of Q2 2016F was 56% compared to 56% for Q2 2015F.

Selling, general and administration expenses for Q2 2016F were at $1,102,587 up $213,162 or 24% compared to $889,425 for Q2 2015F. This is primarily due to the following reasons:

i. Professional fees increased by $80,356 to $131,821 from $51,465 mainly due to higher legal fees.

ii. Advertising and promotion increased by $96,831 to $269,998 from $173,167 mainly due to the reclassification of freight expenses from cost of sales.

Other income and expenses for Q2 2016F increased by $13,844 to $43,939 from $30,095 in Q2 2015F mainly due to higher interest expense on long-term debts.

Six Months Ended December 31, 2015 ("Q2 2016F" and "2016F YTD")

The Company had a net loss and comprehensive loss of $11,033 for 2016F YTD compared to the net income and comprehensive income of $48,702 for the period ended December 31, 2014 ("2015F YTD). The increase in net loss and comprehensive loss is primarily due to the increase in selling, general and administrative expenses of $393,333 offset by the increase in gross margin of $346,511.

Net revenue for 2016F YTD were $4,226,373 up $232,434 or 6% compared to $3,993,939 for 2015F YTD. The increase is mainly due to increased pricing and volumes and optimizing product mix.

The gross margin for 2016F YTD increased by $346,511 or 17% to $2,366,243 compared to $2,019,732 for 2015F YTD. The gross margin percentage of 2016F YTD was up 5% to 56% compared to 51% for 2015F YTD. The increase is mainly due to the reclassification of freight expenses from cost of sales to selling, general and administration expenses.

Selling, general and administration expenses for 2016F YTD were $2,255,481 up $393,333 or 21% compared to $1,862,148 for 2015F YTD. This is primarily due to the following reasons:

i. Advertising and promotion increased by $150,547 to $538,274 from $387,727 mainly due to the reclassification of freight expenses from cost of sales.

ii. Professional fees increased by $325,640 to $422,172 from $96,532 mainly due to higher legal and consulting fees to defend Premier's takeover bid in July 2015.

iii. Automotive expenses increased by $21,097 to $102,636 from $81,539 due to higher expenses on repairs and maintenance of delivery trucks.

Offset by the following:

i. Labour cost decreased by $38,132 to $588,016 from $626,148 mainly due to lower sales commission.

ii. Management fees decreased by $46,167 to $55,500 from $101,667 due to lower bonus payment.

iii. Share-based compensation decreased by $31,200 to $47,479 from $78,679.

Other income and expenses for 2016F YTD increased by $23,409 to $86,016 from $62,607 in 2015F YTD mainly due to higher interest expense on long-term debts.

Summary of Quarterly Results

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

Fiscal Year Quarter	2016F Q1	2016F Q1	2015F Q4	2015F Q3	2015F Q2	2015F Q1	2014F Q4	2014F Q3
(in $000, except per share amounts)	$	$	$	$	$	$	$	$
Net revenues	2,156	2,070	1,952	1,992	1,991	2,003	1,980	1,654
SG&A[(1)]	1,103	1,153	1,499	809	889	1,049	1,058	784
EBITDA[(2)]	187	88	(330)	409	302	26	96	213
Net income (loss)	39	(50)	1,254	299	180	(131)	(187)	63
Net earnings (loss) per share	0.00	(0.00)	0.01	0.00	0.00	(0.00)	(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 Q2 2016F were $2,155,980 up by $85,587 compared to $2,070,393 for Q1 2016F. Net income for Q2 2016F was $38,712 compared to net loss of $49,745 for Q1 2016F. The increase in net income is mainly attributable to the increase in net revenue and decrease in sales, general and administrative expenses. The results in any one quarter are not indicative of results in any other quarter, or for the year as a whole.

LIQUIDITY AND CAPITAL RESOURCES

Financial Condition

At December 31, 2015, the Company had a positive working capital of $1,220,308. The Company has $291,897 of cash and $106,341 of restricted term deposits securing up to $100,000 of bank indebtedness. Current liabilities include $946,408 of accounts payable and accrued liabilities and $770,000 of long-term debt (Note 9 of the consolidated interim financial statements).

The Company has an operating line of credit, one finance leases, four operating leases and one term loan. As at December 31, 2015 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.

Cash Flow

Six Months Ended December 31, 2015 ("2016F YTD")

Cash used in operating activities in 2016F YTD was $20,062 compared to cash provided of $408,686 in 2015F YTD. The decrease in cash provided of $428,748 was primarily due to the decrease in net cash from accounts payable and accrued liabilities of $211,151 and the increase in prepaid expenses and deposits of $210,632, offset by the decrease in accounts receivable of $305,798.

Cash used in 2016F YTD for investing activities was $144,153 mainly for the purchases of property and equipment compared to $222,637 in 2015F YTD.

During the period, the Company received $788,000 in long-term debts, repaid $745,871 in long-term debts and $14,329 in finance lease obligations compared to repayment of $100,000 from bridge loan, $30,408 in bank indebtedness, $200,623 in long-term debt and $16,679 in finance lease obligations in 2015F YTD.

Outstanding Share Data

As at December 31, 2015, 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:

Outstanding Share Data	Number of Common Shares	Exercise Price per Common Share	Expiry Dates
Issued and outstanding as at June 30, 2015	87,083,788	N/A	N/A
Stock options	50,000	$0.10	March 9, 2017
Stock options	4,350,000	$0.07	July 9, 2019
Fully Diluted as of the date of this MD&A	91,483,788	N/A	N/A

Financing

(a) 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% matured 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 December 31, 2015, the Company recorded interest expense of $315 (2014 - $2,674), of which $40 (2014 - $884) 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 loss.

(b) 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 was 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.

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 Fort Garry Brewing Company Ltd. 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.

On July 26, 2013, the Company negotiated to further amend and extend repayment of the balance of $630,000 of the loan in Note 9(b) of the consolidated interim financial statements. 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 Fort Garry Brewing Company Ltd. 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 December 31, 2015, the Company recorded interest expense of $6,100 (2014 - $27,158), of which $1,030 (2014 - $4,588) related to the accretion of the discounted value of the loan. The interest expense has been recorded as interest on long-term debt in the consolidated statement of comprehensive loss. On October 2, 2015, the balance of the loan and interest were repaid in full.

(c) 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. Interest incurred on the loan during the period ended December 31, 2015 was $41,900 (2014 - $23,344) and $nil is owing for interest at December 31, 2015 (June 30, 2015 - $27,654). The Company also recorded interest expense of $41,600 (2014 - $21,219) related to the amortization of finance fees of this loan. 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. 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. On October 2, 2015, the balance of the loan and interest were repaid in full.

(d) On October 1, 2015, the Company entered into a loan agreement with Business Development Bank of Canada ("BDC") for $788,000. The BDC Loan, bearing interest at a base rate of 5.15% plus a variance of 1% maturing April 15, 2023 secured by the assets of Fort Garry Brewing Company and Russell Brewing Company Ltd. During the period ended December 31, 2015, the Company recorded interest expense of $9,911 which has been recorded as interest on long-term debt in the consolidated statement of comprehensive loss

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.

A summary of the Company's contractual obligations for the next five years are as follows (Note 16(c) (ii) of the consolidated interim financial statements):

	Less Than 1 Year $	Years 2 and 3 $	Years 4 and 5 $	More Than 5 Years $	Total $
Accounts payable and accrued liabilities	**946,408**	–	–	–	946,408
Due to related parties and long-term debt	**63,683**	210,000	210,000	297,500	781,183
	1,010,091	210,000	210,000	297,500	1,727,591

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:

	Six Months Ended December 31, 2015	Six Months Ended December 31, 2014
Short-term benefits:		
Salaries and management fees [Note (a)]	**$ 137,901**	$ 176,829
Directors fees [Note (b)]	**18,000**	18,000
Share-based payments [Note (c)]	**47,479**	78,679
	$ 203,380	$ 273,508

(a) During the period ended December 31, 2015, the Company incurred management and miscellaneous fees to a company controlled by the CEO in the amount of $75,237 (2014 – $110,229) and salaries and benefits to the CFO in the amount of $62,664 (2014 – $66,600). As at December 31, 2015, the Company owed $11,183 to a company controlled by the CEO (2014 – $10,384), which is non-interest bearing, unsecured and due on demand.

(b) During the period ended December 31, 2015, the Company incurred director fees of $18,000 (2014 – $18,000). As at December 31, 2015, the Company owed $Nil to the independent directors (2014 – $Nil), which were non-interest bearing, unsecured and due on demand.

(c) During the period ended December 31, 2015, the Company granted nil (2014 – 4,550,000) stock options to directors and key employees and recorded share-based compensation in the amount of $47,479 (2014 – $78,679).

These transactions were in the normal course of operations and have been recorded at their exchange amounts, which is the consideration agreed upon by the related parties.

CRITICAL ACCOUNTING ESTIMATES

The preparation of these 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 interim 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, contingent 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.

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

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.

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.

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 kegs, 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.

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.

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.

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 Brewing Company, A Wee Angry Scotch Ale, Blood Alley Extra Special Bitter, Eastern Promises Czech Pilsner, IP'eh India Pale Ale, Fort Garry Brewing, Fort Garry Dark Ale, Fort Garry Pale Ale, Stone Cold draft, Fort Garry, Two Rivers Brewing Co. Ltd, Frontier, Rocky Mountain Pilsner and Mountains, Russell and The Beer Other Beers Want To Be.

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.

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 Control 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.

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.