



**RUSSELL BREWERIES INC.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED**  
**JUNE 30, 2016 AND 2015**

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## INDEPENDENT AUDITORS' REPORT

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To the Shareholders of  
Russell Breweries Inc.

We have audited the accompanying consolidated financial statements of Russell Breweries Inc. which comprise the consolidated statements of financial position as at June 30, 2016 and 2015, and the consolidated statements of comprehensive income (loss), changes in equity and cash flows for the years then ended, and the related notes comprising a summary of significant accounting policies and other explanatory information.

### **Management's Responsibility for the Consolidated Financial Statements**

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

### **Auditors' Responsibility**

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

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

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

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Russell Breweries Inc. as at June 30, 2016 and 2015 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

*Manning Elliott LLP*

CHARTERED PROFESSIONAL ACCOUNTANTS  
Vancouver, British Columbia  
October 21, 2016

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**RUSSELL BREWERIES INC.****CONSOLIDATED STATEMENTS OF FINANCIAL POSITION****AS AT JUNE 30, 2016 and 2015**

(Expressed in Canadian Dollars)

	2016	2015
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 349,575	\$ 428,312
Accounts receivable (Note 16(c)(i))	775,094	858,708
Inventories (Note 5)	1,140,360	1,017,236
Prepaid expenses and deposits	49,183	46,849
	<b>2,314,212</b>	2,351,105
PROPERTY AND EQUIPMENT (Note 8)	<b>2,501,480</b>	2,438,837
INTANGIBLE ASSETS (Note 6)	<b>1,955,626</b>	1,941,229
RESTRICTED TERM DEPOSITS (Note 7)	<b>107,006</b>	106,341
DEPOSITS	<b>94,169</b>	11,439
DEFERRED TAX ASSETS (Note 12(a))	<b>1,045,000</b>	1,265,000
	<b>\$ 8,017,493</b>	<b>\$ 8,113,951</b>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities (Note 20)	\$ 1,103,190	\$ 1,157,559
Due to related parties (Note 15(a))	11,183	10,561
Current portion of long-term debt (Note 9)	135,960	674,029
Current portion of finance lease obligations	—	14,329
	<b>1,250,333</b>	1,856,478
LONG-TERM DEBT (Note 9)	<b>817,940</b>	18,310
UNEARNED LICENSE FEES (Note 10)	<b>6,250</b>	31,250
	<b>2,074,523</b>	1,906,038
<b>SHAREHOLDERS' EQUITY</b>		
SHARE CAPITAL (Note 11)	<b>12,283,087</b>	12,283,087
SHARE-BASED PAYMENTS RESERVES	<b>3,852,924</b>	3,798,198
DEFICIT	<b>(10,193,041)</b>	(9,873,372)
	<b>5,942,970</b>	6,207,913
	<b>\$ 8,017,493</b>	<b>\$ 8,113,951</b>

COMMITMENTS AND CONTINGENCIES (Note 17)

SUBSEQUENT EVENTS (Note 22)

Approved and authorized for issuance on behalf of the Board of Directors on October 21, 2016:

/s/ Alnesh Mohan

Alnesh Mohan, Director

/s/ Peter H. Stafford

Peter H. Stafford, Director

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

**RUSSELL BREWERIES INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

(Expressed in Canadian Dollars)

	2016	2015
REVENUES (Note 19)	\$ 8,101,838	\$ 7,937,861
COST OF SALES (Notes 5 and 21)	3,846,405	3,600,812
GROSS MARGIN	4,255,433	4,337,049
EXPENSES		
Depreciation (Note 8)	60,849	72,470
Selling, general and administrative (Notes 11(c), 15 and 21)	4,188,562	4,246,150
	4,249,411	4,318,620
EARNINGS BEFORE OTHER INCOME (EXPENSE)	6,022	18,429
OTHER INCOME (EXPENSE)		
Other income (Note 10)	28,349	26,575
Interest income	(5,676)	7,682
Interest on finance lease obligations	715	(13,236)
Other expenses	—	(87,428)
Write-off of long-term investment (Note 10)	—	(100,000)
Interest on long-term debt (Note 9)	(129,079)	(212,844)
	(105,691)	(379,251)
LOSS BEFORE INCOME TAXES	(99,669)	(360,822)
INCOME TAXES (Note 12(c))		
Current tax expense	—	—
Deferred tax (expense) recovery	(220,000)	1,963,000
	(220,000)	1,963,000
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) FOR THE YEAR	(319,669)	1,602,178
EARNINGS (LOSS) PER SHARE (Note 13)		
Basic and diluted	\$ (0.00)	\$ 0.02

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

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**RUSSELL BREWERIES INC.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**(Expressed in Canadian Dollars)

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	Share Capital		Share-based payments reserves	Deficit	Total Shareholders' Equity
	Number of Shares	Amount			
<b>Balance, June 30, 2015</b>	<b>87,083,788</b>	<b>\$12,283,087</b>	<b>\$3,798,198</b>	<b>\$(9,873,372)</b>	<b>\$6,207,913</b>
<b>Comprehensive loss</b>	—	—	—	<b>(319,669)</b>	<b>(319,669)</b>
<b>Share-based compensation</b>	—	—	<b>54,726</b>	—	<b>54,726</b>
<b>Balance, June 30, 2016</b>	<b>87,083,788</b>	<b>\$12,283,087</b>	<b>\$3,852,924</b>	<b>\$(10,193,041)</b>	<b>\$5,942,970</b>

	Share Capital		Share-based payments reserves	Deficit	Total Shareholders' Equity
	Number of Shares	Amount			
<b>Balance, June 30, 2014</b>	<b>87,083,788</b>	<b>\$12,283,087</b>	<b>\$3,570,648</b>	<b>\$(11,475,550)</b>	<b>\$4,378,185</b>
<b>Comprehensive income</b>	—	—	—	<b>1,602,178</b>	<b>1,602,178</b>
<b>Share-based compensation</b>	—	—	<b>227,550</b>	—	<b>227,550</b>
<b>Balance, June 30, 2015</b>	<b>87,083,788</b>	<b>\$12,283,087</b>	<b>\$3,798,198</b>	<b>\$(9,873,372)</b>	<b>\$6,207,913</b>

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

**RUSSELL BREWERIES INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Expressed in Canadian Dollars)

	2016	2015
<b>CASH FLOWS PROVIDED BY (USED IN):</b>		
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$ (319,669)	\$ 1,602,178
Adjusted for non-cash items:		
Deferred income tax expense (recovery) (Note 12(c))	220,000	(1,963,000)
Depreciation	396,657	388,281
Accretion of long-term debt	71,417	120,079
Accrued interest on long-term debt	1,264	85,163
Recognition of unearned license fees (Note 10)	(25,000)	(25,000)
Other expenses	—	87,428
Share-based compensation (Note 11(c))	54,726	227,550
Write-off of long-term investment (Note 10)	—	100,000
	<b>399,395</b>	<b>622,679</b>
Net changes in non-cash working capital items:		
Accounts receivable	83,614	(25,630)
Short-term investments	—	(6,341)
Prepaid expenses and deposits	(85,064)	142,423
Inventories	(123,124)	(149,706)
Due to and from related parties	622	(104,539)
Income taxes payable	—	(171,000)
Accounts payable and accrued liabilities	(54,369)	259,420
	<b>221,074</b>	<b>567,306</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(589,839)	(257,973)
Proceeds on disposal of equipment	—	4,200
Cash grants received (Note 8)	131,789	—
Acquisition of intangible assets	(15,647)	(5,964)
	<b>(473,697)</b>	<b>(259,737)</b>
<b>FINANCING ACTIVITIES</b>		
Proceeds from long-term debt	1,038,000	—
Repayment of demand loan	—	(100,000)
Repayment of bank indebtedness	—	(36,966)
Repayment of long-term debt	(849,785)	(364,973)
Repayment of finance lease obligations	(14,329)	(39,374)
	<b>173,886</b>	<b>(541,313)</b>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(78,737)</b>	<b>(233,744)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>428,312</b>	<b>662,056</b>
<b>CASH AND CASH EQUIVALENTS, ENDING OF YEAR</b>	<b>\$ 349,575</b>	<b>\$ 428,312</b>

SUPPLEMENTAL CASH FLOW INFORMATION (Note 14)

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

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**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

(Expressed in Canadian Dollars)

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**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, 80<sup>th</sup> Avenue, Surrey, British Columbia, V3W 3A8. The Company produces beer primarily for sale to provincial liquor distribution organizations and entities engaged in the food and beverage industries within Canada. The Company's shares are traded on the TSX Venture Exchange (the "TSX.V").

These consolidated financial statements ("Financial Statements") have been prepared on the basis of accounting principles applicable to a going concern, which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

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

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

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

The following companies have been consolidated with Russell Breweries Inc. as at June 30, 2016:

Company Name	Registered	Holding	Functional Currency
Russell Breweries Inc.	British Columbia	Parent Company	Canadian Dollar
Fort Garry Brewing Company Ltd. (i)	Manitoba	100%	Canadian Dollar
Russell USA LLC	United States	100%	United States Dollar

(i) 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.

(ii) Inter-company balances and transactions, and any unrealized gains arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

**c) Basis of Measurement**

The consolidated financial statements have been prepared on the historical cost basis, presented in Canadian dollars, except where otherwise indicated.

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

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

The following discusses the most significant accounting judgments and estimates that the Company has made in the preparation of these consolidated financial statements.

**(i) Significant Judgments****Going Concern**

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

**Deferred Income Taxes**

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

**Impairment Assessments of Long-Lived Assets**

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

**Classification of Non-Current Assets**

Non-current assets or a disposal group are classified as held for sale and reported separately on the consolidated statements of financial position when their carrying amount will be recovered principally through a sale transaction rather than through continuing use and the sale is considered highly probable. Judgment is used in determining what events and circumstances exist to support the determination of highly probable. As at June 30, 2016, management determined that the Company's non-current assets (see Note 22) did not meet the criteria to be classified as held for sale.



**2. STATEMENT OF COMPLIANCE AND BASIS OF PRESENTATION (continued)****(d) Significant Accounting Estimates and Judgments (continued)****(i) Significant Judgments (continued)****Definition of Cash-Generating Units**

The Company assesses whether there are any indicators of impairment for all non-financial assets at the end of each financial reporting period. If such indication exists, the recoverable amount is estimated in order to determine the extent of the impairment loss (if any). When it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Determination of cash-generating units is based on management's best estimate of what constitutes the lowest level at which an asset or group of assets is able to generate cash inflows.

**Long-term Investment**

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

**(ii) Significant Estimates**

Significant areas requiring the use of management estimates include accounts receivable, inventory valuation, the estimated useful lives of long-lived assets, the recoverability of amounts recorded for long-lived assets, estimates used in impairment analyses for intangible assets and property and equipment, valuation of share-based payments, valuation of deferred income tax assets and liabilities and deferred income tax rates. Actual results could differ from the estimates made.

**3. SIGNIFICANT ACCOUNTING POLICIES**

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

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

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

**(ii) Trade Receivables and Payables**

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

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**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

(Expressed in Canadian Dollars)

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**3. SIGNIFICANT ACCOUNTING POLICIES (continued)****(a) Financial Instruments (continued)****(iii) Restricted Term Deposits**

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

**(iv) Long-Term Debt and Due to Related Parties**

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

**(b) Inventories**

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

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

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

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

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

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

**(ii) Repairs and Maintenance**

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

**(d) Intangible Assets**

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

**3. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(e) Impairment of Financial and Non-financial Assets**

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

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

If there are indicators of impairment, an evaluation is undertaken to determine whether the carrying amounts are in excess of their recoverable amounts. An asset's recoverable amount is determined as the higher of its fair value less costs to sell and its value-in-use. Such reviews are undertaken on an asset-by-asset basis, except where assets do not generate cash flows independent of other assets, in which case the review is undertaken at the cash-generating unit level.

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

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

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

**3. SIGNIFICANT ACCOUNTING POLICIES (continued)****(f) Revenue Recognition**

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

**(g) Share-Based Compensation**

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

The Company grants stock options to executive officers, directors, employees and consultants pursuant to a stock option plan described in Note 11(c).

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

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

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

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

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

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

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

**(i) Earnings per Share**

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

**(j) Financing Costs**

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

**(k) Leases**

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

**3. SIGNIFICANT ACCOUNTING POLICIES (continued)****(l) Provisions**

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

**(m) Operating Segments**

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

**(n) Government Assistance**

Government assistance, including tax credits, related to operating expenses is accounted for as a reduction of related expenses. Government assistance, including the investment tax credits related to the acquisition of property and equipment is accounted for as a cost reduction. It is recognized in net (loss) income using the same methods, periods and rates as for the related property and equipment.

**4. ADOPTION OF NEW ACCOUNTING STANDARDS****(a) Newly Adopted Accounting Standards**

The mandatory adoption of the following new and revised accounting standards and interpretations on July 1, 2015 had no significant impact on the Company's consolidated financial statements for the current year or prior year presented. The following standards were adopted for the year ended June 30, 2016:

- Amendments to IAS 1 – Presentation of Financial Statements
- Amendments to IAS 16 – Property, Plant and Equipment

**(b) Future Changes in Accounting Standards**

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

New accounting standards effective January 1, 2016

- *IFRS 10 – Consolidated Financial Statements*. The amendments to IFRS 10 require a full gain or loss to be recognized when a transaction involves a business (whether it is housed in a subsidiary or not), while a partial gain or loss would be recognized when a transaction involves assets that do not constitute a business, even if the assets are housed in a subsidiary. The amendments are effective for transactions occurring in annual periods beginning on or after January 1, 2016.

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**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**(Expressed in Canadian Dollars)

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**4. ADOPTION OF NEW ACCOUNTING STANDARDS (continued)****(b) Future Changes in Accounting Standards (continued)**New accounting standards effective January 1, 2018

- IFRS 15 – *Revenue from Contracts with Customers* - IFRS 15 was issued in May 2014 and specifies how and when an entity will recognize revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers.
- IFRS 9 – *Financial Instruments* – In November 2009, as part of the IASB project to replace IAS 39 Financial Instruments: Recognition and Measurement, the IASB issued the first phase of IFRS 9, that introduces new requirements for the classification and measurement of financial assets. The standard was revised in October 2010 to include requirements regarding classification and measurement of financial liabilities. In November 2013, new general hedge requirements were added to the standard. In July 2014, the final version of IFRS 9 was issued and adds a new expected loss impairment model and amends the classification and measurement model for financial assets by adding a new fair value through other comprehensive income category for certain debt instruments and additional guidance on how to apply the business model and contractual cash flow characteristics.
- IFRS 7 – *Financial instruments: Disclosure*. IFRS 7 was amended to require additional disclosures on transition from IAS 39 to IFRS 9. The standard is effective on adoption of IFRS 9, which is effective for annual periods commencing on or after January 1, 2018.

New accounting standards effective January 1, 2019

- IFRS 16 – *Leases*. IFRS 16 was issued on January 13, 2016, and will be effective for accounting periods beginning on or after January 1, 2019. Early adoption is permitted, provided the Company has adopted IFRS 15. This standard sets out a new model for lease accounting.

The extent of the impact of adoption of these standards and interpretations on the consolidated financial statements of the Company has not yet been determined.

**5. INVENTORIES AND COST OF SALES**

	2016	2015
Finished goods	\$ 202,461	\$ 208,531
Work-in-progress	310,654	317,066
Raw materials	627,245	491,639
	<b>\$ 1,140,360</b>	<b>\$ 1,017,236</b>

During the year ended June 30, 2016, charges of \$Nil (2015 – \$Nil) were recorded in cost of sales relating to obsolete, damaged or unsellable finished goods inventory.

There were no reversals of amounts previously charged to cost of sales in respect of write-downs of inventory for the years ended June 30, 2016 and June 30, 2015.

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**5. INVENTORIES AND COST OF SALES (continued)**

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

	2016	2015
Cash component:		
Inventories	\$ 3,511,847	\$ 3,285,001
Non-cash component:		
Depreciation	334,558	315,811
Cost of sales	\$ 3,846,405	\$ 3,600,812

**6. INTANGIBLE ASSETS**

	Brands and Trademarks	Website	Total
<b>Cost</b>			
Balance as at June 30, 2014	\$ 1,935,268	\$ 5,975	\$ 1,941,243
Additions	\$ 5,961	\$ –	\$ 5,961
Balance as at June 30, 2015	\$ 1,941,229	\$ 5,975	\$ 1,947,204
Additions	\$ 8,150	\$ 7,497	\$ 15,647
<b>Balance as at June 30, 2016</b>	<b>\$ 1,949,379</b>	<b>\$ 13,472</b>	<b>\$ 1,962,851</b>
<b>Accumulated Depreciation</b>			
Balance as at June 30, 2014 and 2015	\$ –	\$ 5,975	\$ 5,975
Depreciation for the year	\$ –	\$ 1,250	\$ 1,250
<b>Balance as at June 30, 2016</b>	<b>\$ –</b>	<b>\$ 7,225</b>	<b>\$ 7,225</b>
<b>Carrying amounts</b>			
June 30, 2014	\$ 1,935,268	\$ –	\$ 1,935,268
June 30, 2015	\$ 1,941,229	\$ –	\$ 1,941,229
<b>June 30, 2016</b>	<b>\$ 1,949,379</b>	<b>\$ 6,247</b>	<b>\$ 1,955,626</b>

**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, 2015 – \$100,000). As at June 30, 2016, accrued interest has been earned on the term deposit in the amount of \$7,006 (2015 - \$6,341).



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**8. PROPERTY AND EQUIPMENT**

	Computer \$	Equipment \$	Leasehold improvements \$	Office furniture and fixtures \$	Vehicles \$	Refundable containers \$	Total \$
<b>Cost</b>							
Balance as at June 30, 2014	77,401	6,033,892	1,342,976	63,844	552,729	907,762	8,978,604
Additions/(Disposals)	530	36,347	165,318	—	(65,757)	54,592	191,030
<b>Balance as at June 30, 2015</b>	<b>77,931</b>	<b>6,070,239</b>	<b>1,508,294</b>	<b>63,844</b>	<b>486,972</b>	<b>962,354</b>	<b>9,169,634</b>
<b>Additions</b>	<b>1,790</b>	<b>448,147</b>	<b>64,450</b>	<b>—</b>	<b>—</b>	<b>75,452</b>	<b>589,839</b>
<b>Assistance received</b>		<b>(108,695)</b>	<b>(23,094)</b>				<b>(131,789)</b>
<b>Balance as at June 30, 2016</b>	<b>79,721</b>	<b>6,409,691</b>	<b>1,549,650</b>	<b>63,844</b>	<b>486,972</b>	<b>1,037,806</b>	<b>9,627,684</b>
<b>Accumulated Depreciation</b>							
Balance as at June 30, 2014	69,704	3,641,370	1,309,836	63,844	458,985	861,520	6,405,259
Disposals	—	—	—	—	(62,743)	—	(62,743)
Depreciation	2,096	263,869	15,646	—	50,826	55,844	388,281
<b>Balance as at June 30, 2015</b>	<b>71,800</b>	<b>3,905,239</b>	<b>1,325,482</b>	<b>63,844</b>	<b>447,068</b>	<b>917,364</b>	<b>6,730,797</b>
<b>Depreciation</b>	<b>2,385</b>	<b>271,345</b>	<b>37,200</b>	<b>—</b>	<b>39,904</b>	<b>44,573</b>	<b>395,407</b>
<b>Balance as at June 30, 2016</b>	<b>74,185</b>	<b>4,176,584</b>	<b>1,362,682</b>	<b>63,844</b>	<b>486,972</b>	<b>961,937</b>	<b>7,126,204</b>
<b>Carrying amounts</b>							
June 30, 2014	\$ 7,697	2,392,522	33,140	—	93,744	46,242	2,573,345
June 30, 2015	\$ 6,131	2,165,000	182,812	—	39,904	44,990	2,438,837
<b>June 30, 2016</b>	<b>\$ 5,536</b>	<b>2,233,107</b>	<b>186,968</b>	<b>—</b>	<b>—</b>	<b>75,869</b>	<b>2,501 480</b>

Equipment includes assets under finance leases with a cost of \$439,719 (2015 – \$439,719) and accumulated depreciation of \$137,876 (2015 – \$118,517). Vehicles includes assets under finance leases with a cost of \$473,775 (2015 – \$473,775) and accumulated depreciation of \$473,775 (2015 – \$433,709). The Company has recognized depreciation of \$60,849 in expenses (2015 - \$72,470) and \$334,558 in cost of sales (2015 - \$315,811).

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**8. PROPERTY AND EQUIPMENT (continued)**

During the year ended June 30, 2016, the Company has received government assistance from Manitoba Agriculture, Food and Rural Development in the amount of \$108,695 (2015 - \$Nil) in relation to a purchase of brewing and cooling equipment for its Winnipeg facility. The assistance received was recognized as a reduction in the cost of equipment purchased. As at June 30, 2016, the Company has received an incentive payment of \$23,094 from Manitoba Hydro in relation to installation of energy efficient lightning in the Company's operating facilities.

**9. LONG-TERM DEBT**

	June 30, 2016	June 30, 2015
Term bank loan, bearing interest at floating base rate plus a variance of 1%, repayable in monthly installments of \$1,750 plus interest matured on August 15, 2015, secured by the assets of Fort Garry (a)	—	\$ 3,210
Term loan, bearing interest at 10% per annum calculated semi-annually, repayable in monthly installments of \$17,500 plus bonus and interest maturing on July 31, 2016, secured by the assets of Russell and Fort Garry (b)	—	234,976
Term loan, bearing interest at 9% per annum calculated semi-annually, secured by a guarantee by a director of the Company, due December 31, 2015 (c)	—	454,153
Term bank loan, bearing interest at a base rate of 5.15% plus a variance of 1%, repayable in monthly installments of \$8,750 plus interest maturing on April 15, 2023, secured by the assets of Russell and Fort Garry (d)	717,500	—
Term bank loan, bearing interest at a base rate of 5.15% plus a variance of 1%, repayable in monthly installments of \$1,750 plus interest maturing on July 15, 2025, secured by the assets of Russell and Fort Garry (e)	190,750	—
Term bank loan, bearing interest at a floating base rate of 4.70% plus a variance of 3%, repayable in monthly installments of \$830 plus interest maturing on January 15, 2021, secured by the assets of Russell and Fort Garry (f)	45,650	—
	<b>953,900</b>	692,339
Less: current portion of long-term debt	<b>(135,960)</b>	(674,029)
Long-term portion of long-term debt	<b>\$ 817,940</b>	<b>\$ 18,310</b>

- (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 year ended June 30, 2016, the Company recorded interest expense of \$315

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**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

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

(2015 - \$3,737), of which \$40 (2015 - \$1,314) 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) As at June 30, 2015, the loan, with a notional principal amount of \$965,000 had 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 was guaranteed by Fort Garry Brewing Company Ltd. As further security for the loan, the Company and its Canadian subsidiaries granted 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 was able to repay the loan at any time without penalty by paying the loan amount outstanding together with accrued interest and prorated bonus. During the year ended June 30, 2016, the Company recorded interest expense of \$7,130 (2015 - \$47,244), of which \$1,030 (2015 - \$7,522) 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 income. On October 2, 2015, the balance of the loan and interest were repaid in full and the security interest was discharged.
- (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 year ended June 30, 2016 was \$12,654 (2015 - \$47,737) and \$nil is owing for interest at June 30, 2016 (2015 - \$27,654). The Company also recorded interest expense of \$70,347 (2015 - \$109,205) related to the amortization of finance fees of this loan of which \$34,462 (2015 - \$31,886) related to the accretion of the discounted value of the loan. The principal amount of the loan was due on December 31, 2015. The Company's obligations under the loan agreement were guaranteed by the Guarantor and, in consideration for acting as guarantor, the Company 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 11(d)). The Company 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 and the security interest was discharged.
- (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. During the year ended June 30, 2016, the Company recorded interest expense of \$32,923 which has been recorded as interest on long-term debt in the consolidated statement of comprehensive loss. The loan is secured by General Security Agreements covering assets of Russell Breweries Inc., Fort Garry Brewing Company Ltd. and a Guarantee of Russell USA LLC for the full amount of the loan.
- (e) On February 3, 2016, the Company entered into a loan agreement with Business Development Bank of Canada ("BDC") for \$200,000. The BDC Loan, bearing interest at a base rate of 5.15% plus a variance of 1% maturing July 15, 2025. During the year ended June 30, 2016, the Company recorded interest expense of \$4,370 which has been recorded as interest on long-term debt in the consolidated statement of comprehensive income. The loan is secured by General Security Agreements covering assets of Russell Breweries Inc., Fort Garry Brewing Company Ltd. and a Guarantee of Russell USA LLC for the full amount of the loan.

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**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

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

- (f) On February 3, 2016, the Company entered into a loan agreement with Business Development Bank of Canada ("BDC") for \$50,000. The BDC Loan, bearing interest at a base rate of 4.70% plus a variance of 3% maturing January 15, 2021. During the year ended June 30, 2016, the Company recorded interest expense of \$1,340 which has been recorded as interest on long-term debt in the consolidated statement of comprehensive loss. The loan is secured by General Security Agreements covering assets of Russell Breweries Inc., Fort Garry Brewing Company Ltd. and a Guarantee of Russell USA LLC for the full amount of the loan.

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

<b>Fiscal Year</b>	<b>Amount</b>
2017	135,960
2018	135,960
2019	135,960
2020	135,960
2021	131,810
2022	126,000
2023	108,500
2024	21,000
2025	21,000
2026	1,750
	<b>\$ 953,900</b>

**10. 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 20% of the common shares of the Licensee ("Licensee Common Shares") with an estimated fair value of \$100,000. During the year ended June 30, 2014, the Company's interest in the Licensee decreased to 7.69% and remained the same as at June 30, 2015 and 2016. As a result, 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. During the year ended June 30, 2015, the Company determined that the long-term investment was not recoverable, and a loss in the amount of \$100,000 was recorded as a write-off of long-term investment in the consolidated statement of comprehensive income.

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 year ended June 30, 2016, the Company has recognized \$1,274 (2015 - \$1,050) in royalties and \$25,000 (2015 - \$25,000) in license fees earned under the agreement, which has been included in other income in the statement of operations. As at June 30, 2016, the unearned license fee is \$6,250 (2015 - \$31,250).

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**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

(Expressed in Canadian Dollars)

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

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

**(b) Issued Share Capital**

There were no changes in issued share capital during the years ended June 30, 2016 and 2015.

**(c) Stock Options**

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

On July 9, 2014, the Company granted 4,550,000 incentive stock options to key employees and directors exercisable at \$0.07 per share expiring five years from the grant date, pursuant to its stock option plan. The options vest with 1/24<sup>th</sup> of the granted options vesting each monthly anniversary of the date of grant for 24 months. 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 5 years; forfeiture rate of 0%, risk-free interest rate of 1.46%; expected dividend yield of 0% and expected stock price volatility of 112%. During the year ended June 30, 2016, the Company recorded \$66,568 (2015 - \$227,550) compensation cost included in selling, general and administrative expense relating to these options.

During the year ended June 30, 2016, a Director resigned resulting in the forfeiture of 200,000 stock options. As a result of the forfeiture, \$11,842 was reversed from contributed surplus and recorded as a reduction to compensation cost in selling, general and administrative expense during the current year.

Stock option activity during the years ended June 30, 2016 and 2015 is presented below:

	2016		2015	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	4,600,000	\$ 0.07	50,000	\$ 0.10
Granted	—	—	4,550,000	0.07
Forfeited	(200,000)	0.07	—	—
Outstanding, end of year	4,400,000	\$ 0.07	4,600,000	\$ 0.07

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

At June 30, 2016, the following stock options are outstanding:

Options Outstanding			Options Exercisable		
Exercise Price \$	Number of Shares	Weighted Average Remaining Life (in years)	Exercise Price \$	Number of Shares	Weighted Average Exercise Price \$
0.10	50,000	0.01	0.10	50,000	0.10
0.07	4,350,000	2.99	0.07	4,160,417	0.07
	4,400,000	3.00	0.07	4,210,417	0.07

**(d) Warrants**

Warrant activity during the years ended June 30, 2016 and 2015 is presented below:

	2016		2015	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding and exercisable, beginning of year	4,000,000	\$ 0.05	13,640,000	\$ 0.09
Granted	—	—	—	—
Expired	(4,000,000)	\$ 0.05	(9,640,000)	0.10
Outstanding, end of year	—	—	4,000,000	\$ 0.05

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**12. INCOME TAXES****(a) Deferred Tax Assets and Liabilities**

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

	2016	2015
Deferred tax assets (liabilities):		
Non-capital losses carried forward	\$ 3,129,000	\$ 3,137,000
Tax value of property and equipment in excess of book value	(110,000)	(58,000)
Tax value of intangible assets in excess of book value	(445,000)	(440,000)
Tax value of long-term debt in excess of book value	-	(19,000)
Tax value of capital losses carried forward	14,000	-
Share and long-term debt issue costs available to be deducted for tax purposes	11,000	20,000
	2,599,000	2,640,000
Unrecognized deferred tax assets	(1,554,000)	(1,375,000)
Net deferred tax assets	\$ 1,045,000	\$ 1,265,000

**(b) Non-Capital Losses Carried Forward and Expiration Dates**

The Company has non-capital losses of approximately \$11,917,000 (2015 - \$11,947,000) 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
2026	56,000
2027	187,000
2028	1,355,000
2029	2,213,000
2030	1,831,000
2031	1,937,000
2032	1,150,000
2033	722,000
2034	765,000
2035	828,000
2036	873,000
	<b>\$ 11,917,000</b>

**(c) Income tax Recovery (Expense)**

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

	2016	2015
Current income tax recovery (expense)	\$ -	\$ -
Deferred income tax recovery (expense)	(220,000)	1,963,000
Total income tax recovery (expense)	\$ (220,000)	\$ 1,963,000

**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

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**12. INCOME TAXES (continued)****(d) Reconciliation of Tax Rates**

The Company is subject to Canadian federal and provincial taxes at an approximate rate of 26% for the year ended June 30, 2016 (2015 – 26%). The reconciliation of the provision for income taxes at the statutory rate compared to the Company's income tax recovery (expense) as reported is as follows:

		<b>2016</b>		<b>2015</b>
Loss (income) before income taxes	\$	<b>99,669</b>	\$	360,822
Statutory tax rate		<b>26%</b>		26%
Expected income tax recovery (expense) at statutory rates		<b>26,000</b>		94,000
Permanent differences		<b>(10,000)</b>		(64,000)
Changes in estimates and other		<b>(12,000)</b>		64,000
Expiry of loss		<b>(45,000)</b>		(13,000)
Change in unrecognized deferred tax assets		<b>(179,000)</b>		1,882,000
Income tax recovery (expense)	\$	<b>(220,000)</b>	\$	1,963,000

**13. EARNINGS (LOSS) PER SHARE**

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

<b>Basic</b>		<b>2016</b>	<b>2015</b>
Net income (loss)	\$	<b>(319,669)</b>	1,602,178
Number of common shares outstanding during the year		<b>87,083,788</b>	87,083,788
Earnings (loss) per share	\$	–	0.02

<b>Diluted</b>		<b>2016</b>	<b>2015</b>
Net income (loss)	\$	<b>(319,669)</b>	1,602,178
Basic number of common shares outstanding during the year		<b>87,083,788</b>	87,083,788
Weighted average number of common shares issuable on dilutive options and warrants, during the year		–	682,089
Diluted number of common shares outstanding during the year		<b>87,083,788</b>	87,765,877
Diluted earnings (loss) per share	\$	–	0.02



**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

(Expressed in Canadian Dollars)

**14. SUPPLEMENTAL CASH FLOW INFORMATION**

	2016	2015
Cash paid for:		
Interest	\$ 57,662	\$ 9,948
Income taxes	\$ –	\$ 171,000

**15. 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:

	2016	2015
Short-term benefits:		
Salaries and management fees [Note 15(a)]	\$ 264,871	\$ 317,348
Directors fees [Note 15(b)]	47,586	36,000
Legal fees [Note 15(d)]	–	12,745
Share-based payments [Note 15(c)]	66,568	227,550
	\$ 379,025	\$ 593,643

- (a) During the year ended June 30, 2016, the Company incurred management and miscellaneous fees to a company controlled by the CEO in the amount of \$127,000 (2015 – \$182,654) and salaries and benefits to the CFO in the amount of \$137,871 (2015 – \$134,694). As at June 30, 2016, the Company owed \$11,183 to a company controlled by the CEO (2015 – \$10,561), which is non-interest bearing, unsecured and due on demand.
- (b) During the year ended June 30, 2016, the Company incurred director fees of \$47,586 (2015 – \$36,000). As at June 30, 2016, the Company owed \$Nil to the independent directors (2015 – \$Nil), which were non-interest bearing, unsecured and due on demand.
- (c) During the year ended June 30, 2016, the Company granted Nil (2015 – 4,550,000) stock options to directors and key employees and recorded share-based compensation in the amount of \$66,568 (2015 – \$227,550) (Note 11 (c)).
- (d) During the year ended June 30, 2016, the Company accrued legal fees of \$Nil (2015 - \$12,745) to a company controlled by a former director of the Company. As at June 30, 2016, the Company had a balance of \$Nil owing to a company controlled by a former director of the Company (2015 - \$57,000).
- (e) During the year ended June 30, 2015, the Company repaid in full, the principal of \$100,000 and interest totaling \$8,551 to spouses of certain directors pursuant to a bridge loan agreement entered on September 3, 2013.
- (f) As at June 30, 2016, the Company has accrued \$74,500 (2015 - \$72,776) in accounts payable and accrued liabilities for bonuses to key management personnel.

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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(Expressed in Canadian Dollars)

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**16. 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, 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 value of long-term debt at June 30, 2016 is considered to be a reasonable estimate 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.

**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 June 30, 2016 consolidated statement of financial position as follows:

	<b>Fair Value Measurements Using</b>			
	<b>Quoted Prices in Active Markets For Identical Instruments (Level 1) \$</b>	<b>Significant Other Observable Inputs (Level 2) \$</b>	<b>Significant Unobservable Inputs (Level 3) \$</b>	<b>Balance as of June 30, 2016 \$</b>
Assets:				
Cash and cash equivalents	349,575	—	—	349,575
Restricted term deposits	107,006	—	—	107,006

**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

(Expressed in Canadian Dollars)

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

Credit risk arises from the non-performance by counterparties of contractual financial obligations. The Company maintains substantially all of its cash and cash equivalents and restricted term deposits with major financial institutions. Deposits held with these institutions may exceed the amount of insurance provided on such deposits. As at June 30, 2016, the Company has significant accounts receivable from two major customer totaling \$654,971 (June 30, 2015 - \$718,590). The Company manages credit risk for trade and other receivables through established credit monitoring activities. As at June 30, 2016, 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:

	2016		2015	
	Over 90 days	Total	Over 90 days	Total
Provincial Liquor Boards	\$ –	\$ 681,400	\$ –	\$ 718,590
Other receivables	–	93,694	–	140,118
<b>Total</b>	<b>\$ –</b>	<b>\$ 775,094</b>	<b>\$ –</b>	<b>\$ 858,708</b>

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 year to year.

**(ii) Liquidity Risk**

Liquidity risk arises from the Company's general and capital financing needs. The Company continuously monitors and reviews both actual and forecasted cash flows, and also matches the maturity profile of financial assets and liabilities, when feasible.

Contractual undiscounted cash flow requirements for financial liabilities as at June 30, 2016 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	1,103,190	–	–	–	1,103,190
Due to related parties and long-term debt	147,143	271,920	267,770	278,250	965,083
	<b>1,250,333</b>	<b>271,920</b>	<b>267,770</b>	<b>278,250</b>	<b>2,068,273</b>

As at June 30, 2016, the Company had a working capital of \$1,063,879 (2015 - \$494,627).

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**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

(Expressed in Canadian Dollars)

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**16. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS (continued)****(c) Financial Risks (continued)****(iii) Interest Rate Price Risk**

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

Certain of the Company's long-term debt instruments 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.

**17. COMMITMENTS AND CONTINGENCIES**

- (a) The Company has entered into operating lease agreements for premises, vehicles and office equipment. The remaining terms of these leases range between 4 and 9 years. Future minimum operating lease payments due as at June 30, 2016 are:

Not later than one year	\$	525,731
Later than one year and not later than five years		1,714,550
Later than five years		608,872
	\$	2,849,153

- (b) At June 30, 2016, the Company had issued a general excise bond of \$45,000 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% secured by a term deposit of \$100,000 (see Note 7). As at June 30, 2016, \$100,000 is undrawn from the line of credit.

**18. 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, 2015 - \$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:

	2016	2015
Long-term debt (Note 9)	\$ 953,900	\$ 692,339
Finance lease obligations	—	14,329
Shareholders' equity	5,942,970	6,207,913
	\$ 6,896,870	\$ 6,914,581

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**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

(Expressed in Canadian Dollars)

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**19. REVENUES**

During the year ended June 30, 2016, the Company had sales of \$5,045,198 (2015 - \$4,957,632) to the Manitoba Liquor & Lotteries which accounted for 62% of its revenues (2015 - 62%) and sales of \$821,544 (2015 - \$905,285) to the British Columbia Liquor Distribution Board which accounted for 10% of its revenues (2015 - 11%).

	2016	2015
GROSS REVENUES	\$ 9,149,787	\$ 9,160,020
LESS: EXCISE TAX AND PROVINCIAL MARK-UP	1,047,949	1,222,159
REVENUES	\$ 8,101,838	\$ 7,937,861

**20. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

The following is a breakdown of accounts payable and accrued liabilities:

	2016	2015
Trade accounts payable	\$ 522,818	\$ 712,869
GST payable	132,330	173,089
Accrued payroll and bonuses	219,304	159,358
Other accrued liabilities	228,738	112,243
	\$ 1,103,190	\$ 1,157,559

**21. EMPLOYEE BENEFITS**

During the year ended June 30, 2016, the Company incurred \$2,152,590 in employee benefits (2015 - \$2,195,178) of which \$1,216,907 (2015 - \$1,282,118) is included in selling, general and administrative expense and \$935,683 (2015 - \$913,060) is included in cost of sales.

**22. SUBSEQUENT EVENTS**

- (a) On October 5, 2016, the Company entered into an agreement to sell the non-current assets and working capital of its Fort Garry Brewing Company business, utilized for the production of beer in Manitoba, for a purchase price of \$7,715,545 ("Fort Garry Sale Agreement"), subject to a required working capital of \$857,328. The purchase price will be adjusted on the closing date on a dollar for dollar basis for any variance in the working capital from the required amount. The closing date of the agreement is December 15, 2016 or any other date as agreed by the parties. The purchase price is to be paid as follows:

- (i) \$6,165,545 in cash;
- (ii) The surrender of a \$200,000 deposit paid in trust on execution of Fort Garry Sale Agreement;
- (iii) The deposit with Computershare Trust Company of Canada of \$1,350,000.

The Company is subject to non-solicitation provisions. The Fort Garry Sale Agreement provides that the Company's Board may, under certain circumstances, terminate the agreement in favour of an unsolicited superior proposal. If the proposal is terminated, the Company will be subject to payment of a termination fee of \$750,000 to the purchaser, and the purchaser is granted a right to match a superior proposal. The sale is subject to the approval by the Company's shareholders.

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**RUSSELL BREWERIES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

(Expressed in Canadian Dollars)

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**22. SUBSEQUENT EVENTS (continued)**

- (b) On October 5, 2016, the Company entered into an agreement to sell the non-current assets and working capital of its Russell Brewing Company business, utilized for the production of beer in British Columbia, for a purchase price of \$1,800,000 ("Russell Sale Agreement"), subject to a required working capital of \$548,123. The purchase price will be adjusted on the closing date on a dollar for dollar basis for any variance in the working capital from the required amount. The closing date of the agreement is December 31, 2016 or any other date as agreed by the parties. The purchase price is to be paid as follows:
- (i) on closing, payment of:
    - \$180,000 in cash; and
    - the surrender of a \$180,000 deposit paid in trust on the execution of the sale agreement; and
  - (ii) the remainder of the purchase price will be payable by the purchaser in instalments as follows:
    - approximately 120 days from the closing date, payment of \$80,000, subject to any working capital adjustments; and
    - at the election of the purchaser, either:
      - i. on the date that is 6 months from the closing of the sale, the deposit with the Escrow Agent of \$200,000, to cover any indemnification claims that may be made by the purchaser for a period of one year following closing, and payment of the remainder of the purchase price, being \$1,160,000, plus interest of 7.5% per annum, compounded annually, on such amounts; or
      - ii. on the date that is 6 months from the closing of the sale, payment of \$680,000 and, on the date that is 12 months from the closing of the sale, payment of \$200,000, subject to any indemnification claims that may be made by the purchaser, and the remainder of the purchase price, being \$480,000, plus interest of 7.5% per annum, compounded annually, on such amounts.

As collateral security for the payment of the remaining instalments of the purchase price, the purchaser has agreed to execute and deliver in favour of the Company, a first ranking general security agreement covering all of the Russell Brewing Company assets.

The Company is subject to non-solicitation provisions. The Russell Sale Agreement provides that the Company's Board may, under certain circumstances, terminate the Agreement in favour of an unsolicited superior proposal. In case of the termination of the Agreement, the Company will be subject to payment of a termination fee of \$160,000 to the purchaser, and the purchaser will be granted a right to match a superior proposal. The sale is subject to the approval by the Company's shareholders.