



RUSSELL BREWERIES INC.
CONDENSED CONSOLIDATED INTERIM
FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED
December 31, 2016 AND 2015

UNAUDITED

NOTICE OF NO AUDITOR REVIEW OF CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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

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

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

RUSSELL BREWERIES INC.**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION****(Unaudited; Expressed in Canadian Dollars)**

	December 31, 2016	June 30, 2016
ASSETS		
Current		
Cash and cash equivalents	\$ 5,067,284	\$ 349,575
Accounts receivable (Note 14(c) (i))	3,048,492	775,094
Inventories (Note 4)	—	1,140,360
Prepaid expenses and deposits	—	49,183
	8,115,776	2,314,212
PROPERTY AND EQUIPMENT (Note 5)	—	2,501,480
INTANGIBLE ASSETS (Note 6)	—	1,955,626
RESTRICTED TERM DEPOSITS (Note 7)	107,006	107,006
DEPOSITS	—	94,169
DEFERRED TAX ASSETS	1,045,000	1,045,000
	\$ 9,267,782	\$ 8,017,493
LIABILITIES		
Current		
Accounts payable and accrued liabilities (Note 18)	\$ 456,426	\$ 1,103,190
Due to related parties (Note 13)	7,269	11,183
Current portion of long-term debt (Note 8)	—	135,960
	463,695	1,250,333
LONG-TERM DEBT (Note 8)	—	817,940
UNEARNED LICENSE FEES (Note 9)	—	6,250
	463,695	2,074,523
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 10)	12,283,087	12,283,087
SHARE-BASED PAYMENTS RESERVES	3,844,741	3,852,924
DEFICIT	(7,323,741)	(10,193,041)
	8,804,087	5,942,970
	\$ 9,267,782	\$ 8,017,493

COMMITMENTS AND CONTINGENCIES (Note 15)

Approved and authorized for issuance on behalf of the Board of Directors on February 28, 2017:

/s/ Alnesh Mohan

Alnesh Mohan, Director

/s/ Peter H. Stafford

Peter H. Stafford, Director

RUSSELL BREWERIES INC.**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(Unaudited; Expressed in Canadian Dollars)**

	Three Months Ended December 31, 2016	Three Months Ended December 31, 2015	Six Months Ended December 31, 2016	Six Months Ended December 31, 2015
REVENUES (Note 17)	\$ 1,234,728	\$ 2,155,980	\$ 3,463,310	\$ 4,226,373
COST OF SALES (Note 4)	781,393	957,602	1,783,054	1,860,130
GROSS MARGIN	453,335	1,198,378	1,680,256	2,366,243
EXPENSES				
Depreciation (Note 5)	11,962	13,140	26,359	35,779
Selling, general and administrative	1,205,110	1,102,587	2,097,205	2,255,481
	1,217,072	1,115,727	2,123,564	2,291,260
EARNINGS (LOSS) BEFORE OTHER INCOME (EXPENSE)	(763,737)	82,651	(443,308)	74,983
OTHER INCOME (EXPENSE)				
Interest on finance lease obligations	—	2,178	—	1,048
Interest on long-term debt	(29,701)	(52,367)	(44,445)	(99,826)
Gain on sale of assets	3,350,803	—	3,350,803	—
Other income (Note 9)	—	6,250	6,250	12,762
	3,321,102	(43,939)	3,312,608	(86,016)
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) FOR THE PERIOD	2,557,365	38,712	2,869,300	(11,033)
EARNINGS (LOSS) PER SHARE (Note 11)				
Basic and diluted	\$ 0.03	\$ 0.00	\$ 0.03	\$ (0.00)

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

	Share Capital		Share-based payments reserves	Deficit	Total Shareholders' Equity
	Number of Shares	Value			
Balance, June 30, 2016	87,083,788	\$12,283,087	\$3,852,924	\$(10,193,041)	\$5,942,970
Comprehensive income for the period	–	–	–	2,869,300	2,869,300
Share-based compensation	–	–	(8,183)	–	(8,183)
Balance, December 31, 2016	87,083,788	\$12,283,087	\$3,844,741	\$(7,323,741)	\$8,804,087

	Share Capital		Share-based payments reserves	Deficit	Total Shareholders' Equity
	Number of Shares	Value			
Balance, June 30, 2015	87,083,788	\$12,283,087	\$3,798,198	\$(9,873,372)	\$6,207,913
Comprehensive loss for the period	–	–	–	(11,033)	(11,033)
Share-based compensation	–	–	47,479	–	47,479
Balance, December 31, 2015	87,083,788	\$12,283,087	\$3,845,677	\$(9,884,405)	\$6,244,359

RUSSELL BREWERIES INC.**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS****(Unaudited; Expressed in Canadian Dollars)**

	Six Months Ended December 31, 2016	Six Months Ended December 31, 2015
CASH FLOWS PROVIDED BY (USED IN):		
OPERATING ACTIVITIES		
Net income (loss) for the period	\$ 2,869,300	\$ (11,033)
Adjusted for non-cash items:		
Depreciation	179,657	199,726
Accretion of long-term debt	—	35,532
Recognition of unearned license fee (Note 9)	(6,250)	(12,500)
Gain on disposition of assets	(3,348,116)	—
Share-based compensation (Note 10 (b))	(8,183)	47,479
	(313,592)	259,204
Net changes in non-cash working capital items:		
Accounts receivable	(2,273,398)	305,798
Prepaid expenses and deposits	143,552	(210,632)
Inventories	1,140,360	(163,903)
Due to and from related parties	—	622
Accounts payable and accrued liabilities	416,086	(211,151)
	(887,192)	(20,062)
INVESTING ACTIVITIES		
Purchase/Disposition of property and equipment	3,436,399	(134,394)
Acquisition/Sale of intangible assets	3,122,402	(9,759)
	6,558,801	(144,153)
FINANCING ACTIVITIES		
Proceeds from long-term debt	—	788,000
Repayment of long-term debt	(953,900)	(745,871)
Repayment of finance lease obligations	—	(14,329)
	(953,990)	27,800
INCREASE IN CASH AND CASH EQUIVALENTS	4,717,709	(136,415)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	349,575	428,312
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 5,067,284	\$ 291,897

SUPPLEMENTAL CASH FLOW INFORMATION (Note 12)

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**

(Unaudited; Expressed in Canadian Dollars)

1. NATURE OF OPERATIONS

Russell Breweries Inc. (the "Company") was incorporated under the laws of the Province of British Columbia, Canada on March 23, 2000. The head office and principal address of the Company are located at #100 - 13018 80th Avenue, Surrey, British Columbia, V3W 3A8. The Company produced 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 NEX board of the TSX Venture Exchange.

These condensed consolidated interim financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that following collection of outstanding accounts receivables and payment of all liabilities, the Company will distribute the remaining assets by way of a return of capital on the common shares, and proceed with the voluntary dissolution in accordance with the Business Corporations Act (British Columbia), and the delisting of the common shares of the Company from the TSX Venture Exchange NEX Board. As at December 31, 2016, the Company had shareholder equity of \$8,804,087 and accumulated losses since inception of \$7,323,741.

On October 5, 2016, the Company entered into an asset purchase agreement to sell substantially all of the assets utilized in its business of producing beers under the name "Fort Garry Brewing Company", for a purchase price of \$7,715,545 (the "Fort Garry Sale"). The purchase price is subject to adjustments to a required working capital of \$857,328 at closing, and is to be paid as follows on execution of the Fort Garry Sale agreement:

- (i) \$6,165,545 in cash;
- (ii) The surrender of a \$200,000 deposit paid in trust; and
- (iii) The deposit with Computershare Trust Company of Canada of \$1,350,000, for working capital and general liability holdbacks.

On December 2, 2016, the Company completed the Fort Garry Sale, and received \$6,165,545 in closing day consideration, as well as the surrender of the \$200,000 in deposit.

On October 5, 2016, the Company also entered into an asset purchase agreement to sell substantially all of the assets utilized in its business of producing beers under the name "Russell Brewing Company", for a purchase price of \$1,800,000 (the "Russell Sale"). The purchase price is subject to adjustments to a required working capital of \$548,123 at closing, and is to be paid as follows on execution of the Russell Sale agreement:

- (i) on closing, payment of:
 - \$180,000 in cash; and
 - the surrender of a \$180,000 deposit paid in trust;
- (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

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**

(Unaudited; Expressed in Canadian Dollars)

1. NATURE OF OPERATIONS (continued)

- 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.

On December 16, 2016, the Company completed the Russell Sale, and received \$180,000 in closing day consideration, and the surrender of \$180,000 in deposit.

As at December 31, 2016, closing day consideration and deposits received, working capital and general liability holdbacks paid in trust with the escrow agent, and the remainder of purchase price payable are summarized as follows:

	Closing day consideration and deposit	Working Capital Holdback	General Liability Holdback	Remainder of Purchase Price Payable, including Working Capital and General Liability Holdbacks	Total Purchase Price
Fort Garry Sale	\$ 6,365,545	\$ 350,000	\$ 1,000,000	\$ -	\$ 7,715,545
Russell Sale	\$ 360,000	\$ -	\$ -	\$ 1,440,000	\$ 1,800,000
					\$ 9,515,545

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

These unaudited condensed consolidated interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB"). The unaudited condensed consolidated interim financial statements do not include all of the information required for full annual financial statements. These condensed consolidated interim financial statements should be read in conjunction with the Company's June 30, 2016 annual audited consolidated financial statements.

The condensed consolidated interim financial statements were authorized for issuance by the Board of Directors on Feb 28, 2017.

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

The following companies have been consolidated with Russell Breweries Inc. as at December 31, 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	0%	United States Dollar

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**

(Unaudited; Expressed in Canadian Dollars)

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

- (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 condensed consolidated interim 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.

d) Significant Accounting Estimates and Judgments

The preparation of these condensed financial statements requires management to make judgments in applying accounting policies. Judgments that have the most significant effect on the amounts recognized in the financial statements may include recovery of accounts receivable, inventory valuation, the estimated useful life of long-lived assets, assessment of long-term investment, estimates used in impairment assessments of long-lived assets, valuation of deferred income tax assets and liabilities and estimates used in calculating share-based compensation. Management also makes assumptions and critical estimates. Critical estimates are those which are most subject to uncertainty and have the most significant risk of resulting in a material change to the carrying amounts of assets and liabilities within the next year. Judgments, assumptions and estimates are based on historical experience, business trends and all available information that management considers relevant at the time of the preparation of the financial statements. However, future events and their effects cannot be anticipated with certainty and so as confirming events occur, actual results could ultimately differ from assumptions and estimates. Such differences could be material.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies that have been used in the preparation of these condensed interim financial statements are summarized in the audited consolidated financial statements of the Company for the year ended June 30, 2016. These statements should be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2016.

4. INVENTORIES AND COST OF SALES

	December 31, 2016	June 30, 2016
Finished goods	—	\$ 202,461
Work-in-progress	—	310,654
Raw materials	—	627,245
	—	\$ 1,140,360

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**

(Unaudited; Expressed in Canadian Dollars)

4. 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:

	Three Months Ended December 31, 2016	Three Months Ended December 31, 2015	Six Months Ended December 31, 2016	Six Months Ended December 31, 2015
Cash component:				
Inventories	\$ 717,141	\$ 866,887	\$ 1,629,756	\$ 1,696,183
Non-cash component:				
Depreciation (Note 5)	64,252	90,715	153,298	163,947
	\$ 781,393	\$ 957,602	\$ 1,783,054	\$ 1,860,130

RUSSELL BREWERIES INC.
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5. PROPERTY AND EQUIPMENT

	Computer \$	Equipment \$	Leasehold improvements \$	Office furniture and fixtures \$	Vehicles \$	Refundable containers \$	Total \$
Cost							
Balance as at June 30, 2015	77,931	6,070,239	1,508,294	63,844	486,972	962,354	9,169,634
Additions	1,790	448,147	64,450	–	–	75,452	589,839
Government assistance received	–	(108,695)	(23,094)	–	–	–	(131,789)
Balance as at June 30, 2016	79,721	6,409,691	1,549,650	63,844	486,972	1,037,806	9,627,684
Additions/(Disposals)	(79,721)	(6,409,691)	(1,549,650)	(63,844)	(486,972)	(1,037,806)	(9,627,684)
Balance as at December 31, 2016	–	–	–	–	–	–	–
Accumulated Depreciation							
Balance as at June 30, 2015	71,800	3,905,239	1,325,482	63,844	447,068	917,364	6,730,797
Depreciation	2,385	271,345	37,200	–	39,904	44,573	395,407
Balance as at June 30, 2016	74,185	4,176,584	1,362,682	63,844	486,972	961,937	7,126,204
Depreciation	1,201	127,723	17,349	–	–	23,748	170,021
Balance as at December 31, 2016	–	–	–	–	–	–	–
Carrying amounts							
June 30, 2015	6,131	2,165,000	182,812	–	39,904	44,990	2,438,837
June 30, 2016	5,536	2,233,107	186,968	–	–	75,869	2,501,480
December 31, 2016	–	–	–	–	–	–	–

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**

(Unaudited; Expressed in Canadian Dollars)

6. INTANGIBLE ASSETS

	Brands and Trademarks	Website	Total
Cost			
Balance as at June 30, 2015	\$ 1,941,229	\$ 5,975	\$ 1,947,204
Additions	\$ 8,150	\$ 7,497	\$ 15,647
Balance as at June 30, 2016	\$ 1,949,379	\$ 13,472	\$ 1,962,851
Additions	\$ 2,902	\$ –	\$ 2,902
Balance as at December 31, 2016	\$ –	\$ –	\$ –
Accumulated Depreciation			
Balance as at June 30, 2015	\$ –	\$ 5,975	\$ 5,975
Depreciation for the year	\$ –	\$ 1,250	\$ 1,250
Balance as at June 30, 2016	\$ –	\$ 7,225	\$ 7,225
Depreciation for the period	\$ –	\$ 1,146	\$ 1,146
Balance as at December 31, 2016	\$ –	\$ –	\$ –
Carrying amounts			
June 30, 2015	\$ 1,941,229	\$ –	\$ 1,941,229
June 30, 2016	\$ 1,949,379	\$ 6,247	\$ 1,955,626
December 31, 2016	\$ –	\$ –	\$ –

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 December 31, 2016, accrued interest has been earned on the term deposit in the amount of \$7,006 (2015 - \$6,341).

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**

(Unaudited; Expressed in Canadian Dollars)

8. LONG-TERM DEBT

	December 31, 2016	June 30, 2016
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 (a)	-	\$ 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 April 15, 2025, secured by the assets of Russell and Fort Garry (b)	-	190,750
Term bank loan, bearing interest at a base rate of 4.70% plus a variance of 3%, repayable in monthly installments of \$830 plus interest maturing on April 15, 2025, secured by the assets of Russell and Fort Garry (c)	-	45,650
		953,900
Less: current portion of long-term debt	-	(135,960)
Long-term portion of long-term debt	-	\$ 817,940

- (a) 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. On December 2, 2016, the Company repaid the loan on closing of the Fort Garry Sale. During the period ended December 31, 2016, the Company recorded interest expense of \$33,306 (2015 - \$nil) including a prepayment indemnity of \$10,321 (2015 - \$nil), which has been recorded as interest on long-term debt in the consolidated statement of comprehensive income.
- (b) 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 April 15, 2025 secured by the assets of Fort Garry Brewing Company and Russell Brewing Company Ltd. On December 2, 2016, the Company repaid the loan on closing of the Fort Garry Sale. During the period ended December 31, 2016, the Company recorded interest expense of \$8,796 (2015 - \$nil) including a prepayment indemnity of \$2,788 (2015 - \$nil), which has been recorded as interest on long-term debt in the consolidated statement of comprehensive income.
- (c) 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 April 15, 2025 secured by the assets of Fort Garry Brewing Company and Russell Brewing Company Ltd. On December 2, 2016, the Company repaid the loan on closing of the Fort Garry Sale. During the period ended December 31, 2016, the Company recorded interest expense of \$2,343 (2015 - \$nil) including a prepayment indemnity of \$796 (2015 - \$nil), which has been recorded as interest on long-term debt in the consolidated statement of comprehensive income.

9. 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 was entitled to ongoing royalties of \$23 per hectolitre of beer produced and sold by the Licensee. The term of the agreement was for four years and expired on October 1, 2016. During the period ended December 31, 2016, the Company has recognized \$nil (2015 - \$262) in royalties and \$nil (2015 - \$12,500) in license fees earned under the agreement. As at December 31, 2016, the unearned license fee is \$nil (June 30, 2016 - \$6,250).

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

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

(b) Stock Options

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

On July 6, 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 1/24th 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 period ended December 31, 2016, the Company recorded \$Nil (2015 - \$ 19,440) compensation cost included in selling, general and administrative expenses relating to these options.

During the period ended December 31, 2016, \$8,183 was reversed from contributed surplus and recorded as a reduction to compensation cost in selling, general and administrative expense, as a result of the forfeiture of 150,000 stock options by two former employees.

Stock option activity during the period ended December 31, 2016 and the year ended June 30, 2016 is presented below:

RUSSELL BREWERIES INC.
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(Unaudited; Expressed in Canadian Dollars)

10. SHARE CAPITAL (continued)

	December 31, 2016		June 30, 2016	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of period	4,400,000	\$ 0.07	4,600,000	\$ 0.07
Forfeited	(150,000)	—	(200,000)	—
Outstanding, end of period	4,250,000	\$ 0.07	4,400,000	\$ 0.07

At December 31, 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	0.19	0.10	50,000	0.10
0.07	4,200,000	2.52	0.07	4,200,000	0.07
	4,250,000	2.52	0.07	4,250,000	0.07

(c) Warrants

Warrant activity during the period ended December 31, 2016 and the year ended June 30, 2016 is presented below:

	December 31, 2016		June 30, 2016	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding and exercisable, beginning of period	—	\$ —	4,000,000	\$ 0.05
Expired	—	—	(4,000,000)	0.05
Outstanding, end of period	—	\$ —	—	\$ —

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**

(Unaudited; Expressed in Canadian Dollars)

11. EARNINGS (LOSS) PER SHARE

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

	Six Months Ended December 31, 2016	Six Months Ended December 31, 2015
Net income (loss)	\$ 2,869,300	\$ (11,033)
Common shares outstanding, beginning of year	87,083,788	87,083,788
Number of common shares outstanding during the year	87,083,788	87,083,788
Earnings (loss) per share (Basic and diluted)	\$ 0.03	\$ (0.00)

The number of shares outstanding used in the computation of loss per share for the period ended December 31, 2016 was 87,083,788 (June 30, 2016 – 87,083,788). Outstanding stock options, warrants, and agent unit options have not been considered in the computation of diluted loss per share as the result is anti-dilutive.

12. SUPPLEMENTAL CASH FLOW INFORMATION

	Six Months Ended December 31, 2016	Six Months Ended December 31, 2015
Cash paid for:		
Interest	\$ 44,445	\$ 50,592

13. 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:

	Six Months Ended December 31, 2016	Six Months Ended December 31, 2015
Short-term benefits:		
Salaries and management fees [Note 13(a)]	\$ 138,813	\$ 137,901
Directors fees [Note 13(b)]	22,000	18,000
Share-based payments [Note 13(c)]	(8,183)	47,479
	\$ 152,630	\$ 203,380

13. RELATED PARTY TRANSACTIONS AND BALANCES (continued)

- (a) During the period ended December 31, 2016, the Company incurred management fees to a company controlled by the CEO in the amount of \$67,098 (2015 - \$75,237) and salaries and benefits to the CFO in the amount of \$71,715 (2015 - \$62,664). As at December 31, 2016, the Company owed \$7,269 to a company controlled by the CEO (2015 - \$11,183), which is non-interest bearing, unsecured and due on demand.
- (b) During the period ended December 31, 2016, the Company incurred director fees of \$22,000 (2015 - \$18,000). As at December 31, 2016, the Company owed \$Nil to the independent directors (2016 - \$Nil), which were non-interest bearing, unsecured and due on demand.
- (c) During the period ended December 31, 2016, the Company granted \$Nil (2015 - \$Nil) stock options to directors and key employees and \$8,183 was reversed from contributed surplus (2015 - \$Nil) (Note 10 (b)).

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.

14. 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 December 31, 2016 are considered to be reasonable estimates of fair value based on current market rates for similar financial instruments.

(b) Fair Value Measurements

Certain of the Company's financial assets and liabilities are measured at fair value on a recurring basis and classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Certain non-financial assets and liabilities may also be measured at fair value on a non-recurring basis. There are three levels of the fair value hierarchy that prioritize the inputs to valuation techniques used to measure fair value, with Level 1 inputs having the highest priority. The levels and the valuation techniques used to value the Company's financial assets and liabilities are described below:

Level 1 - Quoted Prices in Active Markets for Identical Assets

Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Significant Other Observable Inputs

Quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 - Significant Unobservable Inputs

Unobservable (supported by little or no market activity) inputs.

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**

(Unaudited; Expressed in Canadian Dollars)

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

Financial assets and liabilities measured at fair value on a recurring basis were presented on the Company's December 31, 2016 consolidated interim statement of financial position as follows:

	Fair Value Measurements Using			
	Quoted Prices in Active Markets For Identical Instruments (Level 1) \$	Significant Other Observable Inputs (Level 2) \$	Significant Unobservable Inputs (Level 3) \$	Balance as of December 31, 2016 \$
Assets:				
Cash and cash equivalents	5,067,284	—	—	5,067,284
Restricted term deposits	107,006	—	—	107,006

(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.

In accordance with terms of the Russell Sale agreement, the Company received \$360,000 of the total purchase price of \$1,800,000 at closing. The remainder of the purchase price is payable by the purchaser in instalments. As collateral security for the payment of the remaining instalments of the purchase price, the purchaser executed and delivered in favour of the Company, a first ranking general security agreement covering all of the Russell Brewing Company assets. The Company is exposed to credit risk on potential non-performance of the purchaser for payment of the remainder of the purchase price.

(ii) Risk of Indemnification Claims

As part of the Fort Garry Sale and the Russell Sale that closed during the period that ended December 31, 2016, the Company provided representations and warranties of the purchased assets to the purchasers. With the Fort Garry Sale, as at December 31, 2016 a general liability holdback amount of \$1,000,000 was held by the escrow agent in escrow, for potential indemnification claims against these representations and warranties.

In accordance with the terms of the escrow agreement, on first year anniversary of the closing date, the balance of the general liability holdback amount shall be released to the Company, less the aggregate amount of all losses specified in any then unresolved indemnification claims made by the purchasers.

The company is exposed to the risk of potential indemnification claims, which may have a significant effect on the Company's income (loss) and comprehensive income (loss) for the year.

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**(Unaudited; Expressed in Canadian Dollars)

14. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS (continued)**(iii) 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 December 31, 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	456,426	—	—	—	456,426
Due to related parties and long-term debt	7,269	—	—	—	7,269
	463,695	—	—	—	463,695

As at December 31, 2016, the Company had a positive working capital of \$7,652,081.

15. COMMITMENTS AND CONTINGENCIES

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 December 31, 2016, \$100,000 is undrawn from the line of credit.

16. CAPITAL MANAGEMENT

Before completion of the Fort Garry Sale and the Russell Sale, the Company managed its capital structure in order to ensure sufficient resources are available to meet operational requirements. After closing of the sale transactions, capital management goal of the Company is to maximize return of capital on the Common Shares. Management considers its long-term debt, finance lease obligations and shareholders' equity as capital, which consists of the following:

	December 31, 2016	June 30, 2016
Long-term debt (Note 8)	\$ —	\$ 953,900
Shareholders' equity	8,804,087	5,942,970
	\$ 8,804,087	\$ 6,896,870

RUSSELL BREWERIES INC.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED December 31, 2016 AND 2015**

(Unaudited; Expressed in Canadian Dollars)

17. REVENUES

During the period ended December 31, 2016, the Company had sales of \$1,916,940 (2015 - \$2,735,303) to the Manitoba Liquor and Lotteries Commission, which accounted for 55% of its revenues (2015 - 57%).

	Three Months Ended December 31, 2016	Three Months Ended December 31, 2016	Six Months Ended December 31, 2016	Six Months Ended December 31, 2015
GROSS REVENUES	1,413,890	2,430,918	3,895,320	4,778,011
LESS: EXCISE TAX AND PROVINCIAL MARK-UP	179,162	274,938	432,010	551,638
REVENUES	1,234,728	2,155,980	3,463,310	4,226,373

18. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	December 31, 2016	June 30, 2016
Trade accounts payable	\$ 312,514	\$ 522,818
GST payable	143,912	132,330
Accrued payroll and bonuses	—	219,304
Other accrued liabilities	—	228,738
	\$ 456,426	\$ 1,103,190