

RUSSELL BREWERIES INC.
INTERIM CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006 and 2005
(Prepared by Management)

NOTICE OF NO AUDITOR'S REVIEW OF INTERIM FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

CONSOLIDATED STATEMENTS OF CASH FLOWS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**RUSSELL BREWERIES INC.
MANAGEMENT DISCUSSION
December 31, 2006
(Prepared by Management)**

PREPARED AS OF FEBRUARY 27, 2006

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The following discussion and analysis should be read in conjunction with the unaudited consolidated interim financial statements for the three and six months ended December 31, 2006 and 2005 and the audited financial statements for the years ended June 30, 2006 and 2005.

DESCRIPTION OF BUSINESS

Through its wholly owned subsidiary, Russell Brewing Company Ltd., Russell Breweries Inc. ("the Company") owns and operates a Vancouver-based microbrewery through which it produces draught beer for fine pubs and eateries in British Columbia. The Company's facilities, which include corporate offices, a plant, machinery, office equipment and storage, are located in South Surrey. The brewery offers main product lines include Russell Cream Ale, Russell Pale Ale, Russell Honey Blonde Ale, Russell Extra Special Lager, as well as two seasonal brews: Russell Lemon Ale and Russell Christmas Ale.

BUSINESS DEVELOPMENT

In February 2007, the Company ordered new equipment to effectively double the size of its brewery located in Strawberry Hills, Surrey, British Columbia. The order included a bottling line and a canning line to be installed for a summer release of its products in the retail market.

OVERALL PERFORMANCE AND RESULTS OF OPERATIONS

As at December 31, 2006, Russell Breweries Inc., on a consolidated basis, held assets of \$2,040,147 including term deposits of \$936,874, accounts receivable of \$155,016, inventory recorded at \$197,027 and property, plant and equipment recorded at \$654,506. At the same date, the Company had liabilities totaling \$756,163, including bank indebtedness of \$167,118, a \$43,017 demand bank loan, accounts payable and accrued liabilities of \$157,609, current portion of long term bank loan and capital leases of \$145,741 and long term bank loan and capital lease debt of \$242,678.

Prior Period Adjustment

An error in recording sales overstated sales and receivables and understated loss and deficit in prior periods totaling \$88,794. \$25,557 of the error was incurred in the three months ended September 30, 2006. \$18,443 of the error was incurred in the three and six months ended December 31, 2005 and the balance of the error of \$44,794 was incurred in the third and fourth quarters of the year ended June 30, 2006. Prior numbers have been restated to correct for this error.

Current Quarter

See Prior Period Adjustment

Sales for the quarter ended December 31, 2006 were \$341,942 up 4.2% compared to \$328,121 (restated) for the quarter ended December 31, 2005. The gross profit was \$237,454 up 15.1% compared to \$206,269 (restated) for the same period of last year as a result of the increase in sales and an improvement in gross margin.

For the quarter ended December 31, 2006, the net loss was \$366,898 or \$0.03 per share compared to the net loss of \$67,155 (restated) or \$0.01 per share for the comparable period in 2005.

The increase of \$299,743 in net loss was primarily due to an increase of \$58,449 in advertising and promotion, \$25,700 in automotive, \$26,604 in consulting fees, \$5,062 in interest on long-term debt, \$23,514 in office expense & misc., \$11,109 in repairs and maintenance, \$52,776 in labour, \$8,500 in management fees, \$21,065 in professional fees, \$20,620 in transfer agent & filing fees, \$86,976 in stock based compensation, which was offset by an increase of \$31,185 in gross profit, and \$9,034 in interest income. The increases in expense are primarily a result of the Company ramping up its sales activities in anticipation of an expansion of the brewery, employee options expense, completion of a major financing of the Company and costs associated with the migration of the Company from the CNQ Exchange to the TSX Venture Exchange.

Year-to-Date

See Prior Period Adjustment

Sales for the six months ended December 31, 2006 were \$708,006 (restated) up 9.8% compared to \$645,030 (including first quarter restatement) for the six months ended December 31, 2005. The gross profit was \$476,070 (including first quarter restatement) up 20% compared to \$396,817 (restated) for the same period of last year as a result of the increase in sales and an improvement in gross margin.

For the six months ended December 31, 2006, the net loss was \$525,756 (including first quarter restatement) or \$0.04 per share compared to the net loss of \$113,660 (restated) or \$0.01 per share for the comparable period in 2005.

The increase of \$412,096 in net loss was primarily due to an increase of \$104,351 in advertising and promotion, \$33,403 in automotive, \$26,604 in consulting fees, \$9,277 in interest on long-term debt, \$53,611 in office expense & misc., \$14,286 in repairs and maintenance, \$97,436 in labour, \$25,000 in management fees, \$18,810 in professional fees, \$5,178 in rent and utilities, \$25,541 in transfer agent & filing fees, \$86,976 in stock based compensation, which was offset by an increase of \$79,253 in gross profit, and \$9,034 in interest income. The increases in expenses are primarily a result of the Company ramping up its sales activities in anticipation of an expansion of the brewery, employee options expense, completion of a major financing of the Company and costs associated with the migration of the Company from the CNQ Exchange to the TSX Venture Exchange.

SELECTED ANNUAL INFORMATION

The following table presents selected financial information for the six months ended December 31, 2006 and 2005, and the last three fiscal years ended June 30, 2006, 2005 and 2004:

	Six Months Ended	Six Months Ended	Year Ended	Year Ended	Year Ended
	31-Dec-06	31-Dec-05	30-Jun-06	30-Jun-05	30-Jun-04
	Unaudited	Unaudited & Restated	Audited & Restated	Audited	Audited
	\$	\$	\$	\$	\$
Revenue	708,006	645,030	1,300,384	777,054	161,008
Total income (loss) from continuing operations	(525,756)	(113,660)	(382,508)	(624,820)	(132,871)
Operating income (loss) per share	(0.043)	(0.013)	(0.04)	(0.10)	(0.08)
Net income (loss)	(525,756)	(113,660)	(382,508)	(624,820)	(132,871)
Basic and diluted earning (loss) per share	(0.043)	(0.013)	(0.04)	(0.10)	(0.08)
Total assets	2,040,147	1,296,227	1,018,436	944,822	334,064
Total long term financial liabilities	242,678	239,385	242,562	273,863	9,743
Cash dividends declared per share	Nil	Nil	Nil	Nil	Nil

SUMMARY OF QUARTERLY RESULTS

The following is selected financial information from the Company's eight most recently completed fiscal quarters:

Fiscal Year	2007	2007	2006	2006	2006	2006	2005	2005
Quarter	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
		Restated	Restated	Restated	Restated			
	\$	\$	\$	\$	\$	\$	\$	\$
Total revenues	341,942	366,064	375,708	234,203	328,121	316,909	313,815	185,511
Operating loss	(366,898)	(158,858)	(125,978)	(142,870)	(67,155)	(46,505)	(431,197)	(106,794)
Operating loss per share	(0.03)	(0.02)	(0.01)	(0.01)	(0.01)	(0.01)	(0.10)	(0.07)
Total net loss	(366,898)	(158,858)	(125,978)	(142,870)	(67,155)	(46,505)	(431,197)	(106,794)
Total net loss per share	(0.03)	(0.02)	(0.01)	(0.01)	(0.01)	(0.01)	(0.10)	(0.07)

CASHFLOW

For the quarter ended December 31, 2006 the Company used \$452,266 in its operating activities compared to \$130,747 used in the comparative three months ended December 31, 2005, an increase of \$321,519. This was principally a result of an increase of loss of \$299,743 in the quarter ended December 31, 2006 to \$366,898 from \$67,155 in the quarter ended December 31, 2005 and an increased use in non-cash working capital items of \$107,753 in the quarter ended December 31, 2006 principally due to a \$64,735 increase in loans to related parties.

CASHFLOW – Cont'd

For the six months ended December 31, 2006 the Company used \$431,496 in its operating activities compared to \$171,687 used in the six months ended December 31, 2005, an increase of \$259,809. This was principally a result of an increase of loss of \$412,096 in the six months ended December 31, 2006 to \$525,756 from \$113,660 in the six months ended December 31, 2005 net of \$64,314 generated by non-cash working items.

During the quarter ended December 31, 2006 the Company purchased \$161,978 of property, plant and equipment compared to \$23,328 and \$1,495 in deferred costs in the December 2005 quarter, an increase in investing activities of \$137,155.

During the six months ended December 31, 2006 the Company purchased \$168,591 of property, plant and equipment compared to \$32,277 in the six months to December 2005 quarter, an increase in investing activities of \$136,314.

During the quarter ended December 31, 2006 the Company received \$1,435,142 from financing activities compared to \$273,022 in the December 2005 quarter, an increase in financing activities of \$1,162,120. The principle financing activities during the quarter ended December 31, 2006 were shares issued for net cash of \$1,358,500 and capital leases, net of repayments of \$102,720. The principle financing activities during the six months ended December 31, 2005 were share subscription funds received of \$300,000.

During the six months ended December 31, 2006 the Company received \$1,403,964 from financing activities compared to \$357,769 in the six months to December 2005, an increase in financing activities of \$1,046,195. The principle financing activities during the six months ended December 31, 2006 were shares issued for net cash of \$1,358,500 and capital leases, net of repayments of \$95,197. The principle financing activities during the six months ended December 31, 2005 were share subscription funds received of \$411,250.

LIQUIDITY AND CAPITAL RESOURCES

Russell Breweries Inc. generates revenue through the distribution of beer produced by its wholly owned subsidiary, Russell Brewing Company Ltd. In the six months ended December 31, 2006, the Company realized revenue of \$708,006 through the sale of its beer products. However, due to cost of sales of \$231,936, operating expenses of \$1,010,860 and interest income of \$9,034, the Company incurred a net loss of \$525,756 for the same period.

To fund its ongoing operations, the Company completed a brokered private placement on October 17, 2006, raising gross proceeds of \$1,500,000. Net proceeds were \$1,358,500 after issue costs, which consisted of a commission of 7.5% of gross proceeds and 1,000,000 one year term broker warrants to purchase shares at \$0.30, a \$5,000 administrative fee, a corporate finance fee of 100,000 common shares issued at \$0.30 and 100,000 share purchase warrants to purchase shares at \$0.50, and Bolder Investment Partners, Ltd., the agent, was reimbursed of all expenses related to the private placement.

Subsequent to December 31, 2006 the Company has received \$75,000 in respect of the exercise of 250,000 broker warrants to purchase common stock at \$0.30 and \$362,500 in respect of the exercise of 725,000 warrants to purchase stock at \$0.50

LIQUIDITY AND CAPITAL RESOURCES – Cont'd

In addition, Russell Breweries Inc. had accounts receivable at December 31, 2006 of \$155,016, which it reasonably expects to collect. Most administrative expenses will be paid from expected revenue from operations. The funds from this private placement will also be used to acquire additional capital equipment, including a bottling line, and for acquisitions.

Russell Breweries Inc. does not currently have a specific plan regarding how it will obtain future funding. However, management anticipates that additional financing will be obtained through the sale of its common shares.

The Company has the following outstanding commitments with respect to its assets:

- a) The Company acquired a vehicle under a capital lease from Suzuki Canada Credit with a term of two years. This lease bears interest at a rate of 0.90% per annum, and is repayable in monthly installments of \$313, plus interest. The lease is secured against the vehicle subject to the lease. The lease was paid in full February 28, 2006. The Company exercised the buyout and purchased the vehicle in April 2006.
- b) The Company acquired three additional vehicles under a capital lease from Totem Leasing with a term of three years. This lease bears interest at a rate of 12.5% per annum, and is repayable in monthly installments of \$862, plus interest. The lease is secured against the vehicles subject to the lease.
- c) In July 2004, the Company obtained a Canadian government guaranteed bank loan from Scotia Bank in the amount of \$250,000. The Company has drawn down against the bank the amount of \$242,743. The principal is being repaid on a straight line basis over 54 months from January 2005.
- d) The Company entered into an operating lease for its premises which expires January 2007, with an option to renew for a further three years. Refer to Note 12 to the Company's financial statements for the period ended June 30, 2006. On February 1, 2007, the Company renewed the lease for another three years.
- e) During the year ended June 30, 2004, the Company received a loan of \$150,000 from Vancouver City Savings & Credit Union with a term of four years. The loan bears interest at prime plus 3% per annum, repayable in monthly installments of \$3,125, plus interest. The loan is secured by a demand promissory note, a general security agreement against all of the Company's property and a guarantee of postponement of claim of \$37,500 by a director of the Company.
- f) In January 2006, the Company acquired a vehicle under a capital lease from Jim Pattison Lease with a term of 24 months. This lease bears interest at 7.95% per annum, and is repayable in monthly installments \$219, plus interest. The lease is secured against the vehicles subject to the lease.
- g) In February 2006, the Company acquired a vehicle under a capital lease from Jim Pattison Lease with a term of 36 months. This lease bears interest at 8.10% per annum, and is repayable in monthly installments \$264, plus interest. The lease is secured against the vehicles subject to the lease.

LIQUIDITY AND CAPITAL RESOURCES – Cont'd

- h) In June 2006, the Company acquired a forklift under a capital lease from Jim Pattison Lease with a term of 48 months. This lease is repayable in monthly installments \$400, plus interest. The lease is secured against the vehicles subject to the lease.
- i) In November 2006, the Company acquired a vehicle under a capital lease from Jim Pattison Lease with a term of 36 months. This lease bears interest at a rate of 9.5% per annum, and is repayable in monthly installments of \$251. The lease is secured against the vehicles subject to the lease.
- j) In November 2006, the Company acquired a vehicle under a capital lease from Jim Pattison Lease with a term of 36 months. This lease bears interest at a rate of 17.53% per annum, and is repayable in monthly installments of \$318. The lease is secured against the vehicles subject to the lease.
- k) In December 2006, the Company acquired a vehicle under a capital lease from Jim Pattison Lease with a term of 36 months. This lease bears interest at a rate of 18.67% per annum, and is repayable in monthly installments of \$284. The lease is secured against the vehicles subject to the lease.
- l) In December 2006, the Company acquired a truck under a capital lease from Jim Pattison Lease with a term of 61 months. This lease bears interest at a rate of 12.74% per annum, and is repayable in monthly installments of \$1,553. The lease is secured against the vehicles subject to the lease.

MANAGEMENT

Russell Breweries Inc.'s Board of Directors consists of Brian Harris, Andrew Harris and John Morgan. Mr. Andrew Harris acts as President. During the six months ended December 31, 2006, the Company paid or accrued management fees of \$48,000 to Brian Harris and Andrew Harris, a salary of \$28,000 to John Morgan, and total compensation for services to various relatives of Brian Harris and Andrew Harris of \$56,190. Brian Harris and Andrew Harris are father and son.

SHARE DATA

As of the date of this management discussion, Russell Breweries Inc. has 16,097,135 common shares without par value issued and outstanding.

INVESTOR RELATIONS

No investor relations activities were undertaken by or on behalf of the Company during the period.

ADDITIONAL INFORMATION

Additional information relating to Russell Breweries Inc. is located at www.sedar.com and www.russellbeer.com.

RUSSELL BREWERIES INC.

December 31, 2006

NOTICE OF NO AUDITOR REVIEW OF 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 interim consolidated financial statements of the Company have been prepared by management and approved by the Audit Committee and Board of Directors of the Company.

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

RUSSELL BREWERIES INC.
INTERIM CONSOLIDATED BALANCE SHEETS
(Prepared by Management)

	(Unaudited)	(Audited and Restated)
	<u>31-Dec-06</u>	<u>30-Jun-06</u>
ASSETS		
CURRENT		
Term deposits	\$ 936,874	\$ 101,318
Accounts receivables (Note 12)	155,016	140,166
Due from related parties (Note 5)	79,138	17,437
Inventory (Note 6)	197,027	188,110
Prepaid expenses and deposits	14,581	20,243
	1,382,636	467,274
 PROPERTY, PLANT AND EQUIPMENT (Note 7)	 654,506	 547,130
TRADEMARKS	1,800	1,800
DEFERRED COSTS	1,205	2,232
	\$ 2,040,147	\$ 1,018,436
LIABILITIES		
CURRENT		
Bank indebtedness	\$ 167,118	\$ 135,439
Demand bank loan (Note 8)	43,017	63,546
Accounts payable and accrued liabilities	157,609	132,761
Current portion of long-term debt (Note 9)	50,004	50,004
Current portion of obligations under capital leases (Note 10)	95,737	29,860
	513,485	411,610
 LONG TERM DEBT (Note 9)	 92,696	 121,900
OBLIGATIONS UNDER CAPITAL LEASES (Note 10)	149,982	120,662
	756,163	654,172
SHAREHOLDERS' DEFICIENCY		
SHARE CAPITAL (Note 3)	2,729,865	1,371,365
CONTRIBUTED SURPLUS	336,258	249,282
DEFICIT (Note 12)	(1,782,139)	(1,256,383)
	1,283,984	364,264
	\$ 2,040,147	\$ 1,018,436

APPROVED BY THE DIRECTORS:

/s/ Andrew Harris, Director

/s/ Brian Harris, Director

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

RUSSELL BREWERIES INC.
INTERIM CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
For the three and six months ended December 31, 2006 and 2005
(Unaudited - Prepared by Management)

	Three months ended		Six months ended	
	<u>31-Dec-06</u>	<u>31-Dec-05</u> (Restated)	<u>31-Dec-06</u>	<u>31-Dec-05</u> (Restated)
SALES (Note 12)	\$ 341,942	\$ 328,121	\$ 708,006	\$ 645,030
COST OF SALES	<u>104,488</u>	<u>121,852</u>	<u>231,936</u>	<u>248,213</u>
	<u>237,454</u>	<u>206,269</u>	<u>476,070</u>	<u>396,817</u>
EXPENSES				
Amortization	35,590	36,589	71,625	70,628
Interest on long-term debt	9,603	4,541	18,339	9,062
Selling, general and administrative	<u>568,193</u>	<u>232,294</u>	<u>920,896</u>	<u>430,787</u>
	<u>613,386</u>	<u>273,424</u>	<u>1,010,860</u>	<u>510,477</u>
OTHER ITEMS				
Interest income	(9,034)	-	(9,034)	-
NET LOSS FOR THE PERIOD	<u>366,898</u>	<u>67,155</u>	<u>525,756</u>	<u>113,660</u>
Deficit, beginning of the period				
As previously reported	1,326,447	920,380	1,193,146	873,875
Prior period adjustment (Note 12)	<u>88,794</u>	<u>-</u>	<u>63,237</u>	<u>-</u>
Adjusted balance of deficit, beginning of the period	<u>1,415,241</u>	<u>920,380</u>	<u>1,256,383</u>	<u>873,875</u>
Deficit, end of the period	<u>\$ 1,782,139</u>	<u>\$ 987,535</u>	<u>\$ 1,782,139</u>	<u>\$ 987,535</u>
Basic and diluted loss per share	<u>\$ 0.03</u>	<u>\$ 0.01</u>	<u>\$ 0.04</u>	<u>\$ 0.01</u>
Weighted average number of shares outstanding	<u>14,456,918</u>	<u>8,658,469</u>	<u>12,239,526</u>	<u>8,658,469</u>

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

RUSSELL BREWERIES INC.
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three and six months ended December 31, 2006 and 2005
(Unaudited - Prepared by Management)

CASH FLOWS PROVIDED BY (USED FOR):	Three months ended		Six months ended	
	<u>31-Dec-06</u>	<u>31-Dec-05</u> (Restated)	<u>31-Dec-06</u>	<u>31-Dec-05</u> (Restated)
OPERATING ACTIVITIES				
Net loss for the period	\$ (366,898)	\$ (67,155)	\$ (525,756)	\$ (113,660)
Adjusted for non-cash items:				
Amortization	35,590	36,589	71,625	70,628
Stock compensation expenses	86,976	-	86,976	-
	<u>(244,332)</u>	<u>(30,566)</u>	<u>(367,155)</u>	<u>(43,032)</u>
Changes in non-cash working capital items:				
Accounts receivable	(66,476)	(28,314)	(14,850)	(67,238)
Prepaid expenses and deposits	2,652	(4,010)	5,662	(10,233)
Inventory	(16,359)	(13,150)	(18,300)	(8,322)
Accounts payable and accrued liabilities	(55,016)	(46,707)	24,848	(34,854)
Due to and from related parties	(72,735)	(8,000)	(61,701)	(8,008)
	<u>(452,266)</u>	<u>(130,747)</u>	<u>(431,496)</u>	<u>(171,687)</u>
INVESTING ACTIVITIES				
Deferred costs	-	(1,495)	-	-
Purchase of property and equipment	(161,978)	(23,328)	(168,591)	(32,277)
	<u>(161,978)</u>	<u>(24,823)</u>	<u>(168,591)</u>	<u>(32,277)</u>
FINANCING ACTIVITIES				
Capital lease, net of repayments	102,720	(5,519)	95,197	(10,303)
Bank loan, net of repayments	(16,703)	(12,501)	(29,204)	(25,002)
Demand loan repayments	(9,375)	(8,958)	(20,529)	(18,176)
Share capital issued for cash	1,358,500	-	1,358,500	-
Share subscriptions	-	300,000	-	411,250
	<u>1,435,142</u>	<u>273,022</u>	<u>1,403,964</u>	<u>357,769</u>
Increase (decrease) in cash during the period	820,898	117,452	803,877	153,805
Cash, beginning of period	(51,142)	120,398	(34,121)	84,045
Cash and term deposits, end of period	<u>\$ 769,756</u>	<u>\$ 237,850</u>	<u>\$ 769,756</u>	<u>\$ 237,850</u>
Supplemental disclosure of cash flow information:				
Cash paid for:				
Interest	<u>\$ 9,603</u>	<u>\$ 4,542</u>	<u>\$ 18,339</u>	<u>\$ 9,062</u>
Income Taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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

RUSSELL BREWERIES INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

(Prepared by Management)

Note 1 Interim Financial Statements

While the information presented in these interim consolidated financial statements is unaudited, it includes all adjustments which are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows for the interim period presented. These interim financial statements follow the same accounting policies and methods of their application as the Company's June 30, 2006 financial statements. It is suggested that these interim financial statements be read in conjunction with the Company's annual June 30, 2006 audited financial statements.

Note 2 Significant Accounting Policies

a) Principles of Consolidation

These financial statements have been prepared on a consolidated basis and include the accounts of the Company and its wholly owned subsidiary, Russell Brewing Company Ltd. All significant intercompany transactions and balances have been eliminated.

b) Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments, which are readily convertible into cash with maturities of three months or less when acquired. As at December 31, 2006, cash equivalents consisted of term deposits of \$936,874, of which \$100,000 secured a \$100,000 business line of credit on the chequing account with TD Canada Trust with an interest rate of 3.55% per annum maturing October 17, 2007.

c) Estimates, Assumptions and Measurement Uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ materially from those estimates and assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

d) Financial Instruments

The fair values of cash and cash equivalents, accounts receivable, inventory, prepaid expenses, demand bank loan, due to / from related parties, accounts payable and accrued liabilities were estimated to approximate their carrying values due to the immediate or short term maturity of these financial instruments. It was not practicable to determine the fair value of the amounts due to / from the related parties. The amounts due to / from the related parties are non-interest bearing and have no specific terms of repayment. Management does not believe the Company is exposed to significant credit, foreign currency or interest rate risks.

e) Loss per Share

Basic and diluted loss per share figures is calculated using the weighted monthly average number of shares outstanding during the respective fiscal periods. Diluted loss per common share amounts reflects the effects of potentially dilutive securities, including stock options, when dilutive, under the treasury stock method.

RUSSELL BREWERIES INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

Note 2 Significant Accounting Policies – (cont'd)

f) Revenue Recognition

Revenue is recognized upon delivery of product to the customer, and when collection is reasonably assured. Net revenue represents the gross revenues of \$857,389 (2005: \$794,105) less applicable duties and fees levied by the applicable provincial liquor board.

g) Inventory

Raw materials, work-in-process and finished goods are valued at the lower of cost and net realizable value. Returnable containers are recorded at cost and are amortized over their useful lives.

h) Deferred Financing Costs

Deferred financing costs represent the cost of issuance of long-term debt. Amortization is provided on a straight-line basis over the term of the debt.

i) Property, Plant and Equipment

Property, plant and equipment are recorded at cost and amortized on the declining balance basis at the following annual rates: computers – 30%; equipment – 30%; office furniture and fixtures – 20%; vehicles – 30%; website – 30%. Leasehold improvements are amortized on a straight line basis over 5 years.

j) Stock-based Compensation Plans

The Company grants stock options under a fixed stock option plan in accordance with the TSX Venture Exchange policies (Note 4). Any consideration paid by directors and employees on exercise of stock options is credited to share capital. The Company follows the recommendations exercise of the Canadian Institute of Chartered Accountants with respect to Section 3870 "Stock-Based Compensation and Other Stock-Based Payments". The recommendations require the expensing of all stock-based compensation awards using a fair value based method of accounting.

k) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Future income 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 tax rates expected to apply when these differences reverse. A valuation allowance is recorded against any future tax asset if it is more likely than not that the asset will not be realized.

The Company has non-capital losses for Canadian income tax purposes of approximately \$957,000 to be used to reduce future taxable income in Canada, which expires commencing in fiscal 2007. In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of future tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of the future tax asset considered realizable could change materially in the near term based on future taxable income during the carry forward period. A valuation allowance has been provided against all net future tax assets, as realization of such net assets is uncertain.

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2006

Note 3 Share Capitala) Authorized

400,000,000 common shares, without par value

b) Issued

	31-Dec-06		31-Dec-05	
	Shares	Amount	Shares	Amount
Balance, beginning	10,022,135	\$ 1,371,365	1,538,334	\$ 254,050
Forward split (4:1)			4,615,002	-
For debt	-	-	395,667	101,362
For cash:				
Private placement	5,000,000	1,500,000	2,109,466	504,578
Finder's fee	-	(112,500)	-	-
Share issue costs	100,000	(29,000)	-	-
Balance, ending	<u>15,122,135</u>	<u>\$ 2,729,865</u>	<u>8,658,469</u>	<u>\$ 859,990</u>

On October 23, 2006, the Company commenced trading on the TSX Venture Exchange.

c) Escrow Shares

At December 31, 2006, 661,500 (2005: 1,102,500) common shares of the Company outstanding capital are held in escrow for some directors of the Company and will be released as follows:

Date of Release	Shares
May 2, 2007	220,500
November 2, 2007	220,500
May 2, 2008	220,500
	<u>661,500</u>

On November 18, 2006, 220,500 escrow shares were released.

d) Private Placement

During the year ended June 30, 2006, the Company issued 1,363,666 common shares pursuant to a series of private placements for net proceeds of \$511,375.

In October 2006, the Company closed a brokered private placement of 5,000,000 units at a price of \$0.30 per unit for total proceeds of \$1,500,000, net proceeds of \$1,358,500. Each unit consists of one common share and one non-transferable common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at \$0.50 for a period of two years from completion of the financing subject to an early expiry provision. Upon closing, the brokered agent received a cash commission equal to 7.5% of the gross proceeds. The agent also received 1,000,000 common share purchase warrants exercisable for a period of two years at a price of \$0.30 per unit, an administrative fee of \$5,000, a corporate finance fee of 100,000 common shares, and was reimbursed of all reasonable expenses related to the private placement. All shares issued pursuant to this financing, and shares issued pursuant to the exercise of the agent's warrants, are subject to a four month hold period.

RUSSELL BREWERIES INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

Note 3 Share Capital - (cont'd)e) Share Purchase Warrants

At December 31, 2006, the following share purchase warrants were outstanding entitling the holders the right to purchase one common share for each warrant held:

Warrants	Exercise Price	Expiry Date
5,100,000	\$ 0.500	17-Oct-08
1,000,000	\$ 0.300	17-Oct-08

Note 4 Stock Option Plan

The Board of Directors is authorized, pursuant to the Company's Stock Option Plan to grant options to directors, officers, consultants or employees acquiring up to 10% of the issued and outstanding common shares from time to time. The exercise price will not be less than the market price of the common shares less applicable discounts permitted by the TSX Venture Exchange. The options may be granted under this plan exercisable over a period not exceeding five years.

In May 2005 the Company granted stock options to purchase up to 885,000 common shares exercisable at a price of \$ 0.58 per share on or before May 18, 2009. In April 2006, these stock options were cancelled and the Company granted 1,000,000 incentive stock options exercisable at a price of \$0.33 per share and an expiry date of April 13, 2011. On June 15, 2006, 250,000 of these stock options were cancelled.

On October 20, 2006, the Company issued 760,000 stock options exercisable for a period of 5 years at a price of \$0.48 per share. Meanwhile, the Company cancelled 10,000 stock options exercisable at \$0.33 per share with an expiry date of April 13, 2011.

A summary of the status of the Company's stock option plan as of December 31, 2006 and December 31, 2005 and changes during the periods then ended is presented below:

	31-Dec-06		31-Dec-05	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning balance	750,000	\$ 0.33	885,000	\$ 0.58
Granted	760,000	0.48	-	-
Exercised	-	-	-	-
Forfeited/Cancelled	(10,000)	0.33	-	-
Outstanding, ending balance	1,500,000	\$ 0.41	885,000	\$ 0.58

At December 31, 2006, 1,500,000 share purchase options were outstanding entitling the holders thereof the right to purchase one common share for each option held as follows:

Options	Exercise Price	Expiry Date
740,000	\$ 0.33	13-Apr-11
760,000	\$ 0.48	20-Oct-11

RUSSELL BREWERIES INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

Note 4 Stock Option Plan - (cont'd)

The fair values of the options granted during the six months ended December 31, 2006 and the year ended June 30, 2006 were estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Six Months Ended <u>31-Dec-06</u>	Year Ended <u>30-Jun-06</u>
Risk-free interest rate	4.50%	4.31%
Dividend yield	0%	0%
Expected stock price volatility	15%	120%
Expected life of options	5 years	5 years
Weighted average fair value per share	\$0.12	\$0.33

For the year six months ended December 31, 2006, the Company recognized stock based compensation in the amount of \$86,976 representing the issuance of 760,000 stock options at \$90,300, less the cancellation of 10,000 stock options at \$3,324.

Note 5 Due from/to Related Parties

a) At December 31, 2006, directors of the Company were indebted to the Company for \$79,138 (2005: \$59,568) from cash advances. Among these advances, \$30,000 are bearing interest at 8% per annum, unsecured, without specific terms of repayment. The rest amounts are unsecured, non-interest bearing and have no specific terms of repayment.

b) During the six months ended December 31, 2006 and 2005, the Company incurred the following charges with directors of the Company and relatives of directors:

	<u>31-Dec-06</u>	<u>31-Dec-05</u>
Compensation paid to relatives of directors	\$ 56,190	\$ 34,200
Consulting fees and salaries paid to directors	28,000	-
Management fees paid to directors	48,000	23,000
	<u>\$ 132,190</u>	<u>\$ 57,200</u>

The above transactions were recorded at exchange value, which was the amount of consideration established and agreed to by the related parties.

c) In October 2006, a director purchased 250,000 common shares in the Company through a private placement for \$75,000.

Note 6 Inventory

	<u>31-Dec-06</u>	<u>31-Dec-05</u>
Finished goods and work-in-progress	\$ 25,092	\$ 17,141
Raw materials	4,744	12,240
Returnable containers and small ware, net of amortization	167,191	127,489
	<u>\$ 197,027</u>	<u>\$ 156,870</u>

RUSSELL BREWERIES INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

Note 7 Property, Plant and Equipment

	31-Dec-06			31-Dec-05
	Cost	Acc. Depr.	Net	Net
Computers	\$ 16,117	\$ 9,663	\$ 6,454	\$ 7,722
Equipment	492,231	163,793	328,438	287,792
Leasehold improvements	25,326	5,070	20,256	2,386
Office furniture and fixtures	9,827	2,977	6,850	8,368
Vehicles	419,322	129,769	289,553	164,388
Website	4,825	1,870	2,955	6,682
	<u>\$ 967,648</u>	<u>\$ 313,142</u>	<u>\$ 654,506</u>	<u>\$ 477,338</u>

Note 8 Demand Bank Loan

Consists of a Vancouver City Savings Credit Union loan with an original term of four years, repayable in monthly installments of \$3,125 plus interest at bank prime rate plus 3% per annum. The loan is secured by a Demand Promissory Note, a general security agreement against all property of the Company, and a guarantee and postponement of claim of \$37,500 by a director of the Company. In accordance with the Canadian Institute of Chartered Accountants Emerging Issues Committee EIC 122 "Balance Sheet Classification of Callable Debt Obligations Expected to Be Refinanced", this obligation has been classified as a current liability.

Note 9 Long Term Debt

In July 2004, the Company obtained a Canadian government guaranteed bank loan from Scotia Bank in the amount of \$250,000. To December 31, 2006 the Company has drawn down \$242,743 against this amount. Repayment was interest only at bank prime rate plus 2.5% per annum until December 31, 2004. Commencing January 2005, repayment was \$4,167 per month plus interest at the bank prime rate plus 2.5%, maturing in December, 2010. The loan is secured by a general security agreement over present property and property acquired in the future including all equipment, goods and inventory, property insurance showing loss payee as the Scotia Bank, as well as a personal guarantee of a director in the amount of \$62,500.

	Principal Amount
Loan amount as at December 31, 2006	\$ 142,700
Current portion of long term debt	<u>(50,004)</u>
	<u>\$ 92,696</u>

Future principal repayments are as follows:

fiscal year ending 2007	\$ 25,002
fiscal year ending 2008	50,004
fiscal year ending 2009	50,004
fiscal year ending 2010	<u>17,690</u>
	<u>\$ 142,700</u>

RUSSELL BREWERIES INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

Note 10 Obligations under Capital Leases

The following is a schedule of the future minimum lease payments of the capital leases expiring on various dates, together with the balance of the obligations.

	Capital Leases
Fiscal years ending 2007	\$ 39,591
Fiscal years ending 2008	118,895
Fiscal years ending 2009	55,994
Fiscal years ending 2010	64,360
Fiscal years ending 2011	20,946
Fiscal years ending 2012	11,635
	<hr/>
	311,421
Less amount representing interest ranging from 1% to 19%	(65,702)
Present value of net minimum lease payments	245,719
Less current portion of capital lease payments	(95,737)
	<hr/>
	<u>\$ 149,982</u>

Note 11 Other Commitments

The Company entered into an operating lease for its premises which expires January 2007, with an option to renew for a further three years. In September 2004 the Company leased additional space under the same terms and conditions as the existing space.

	Operation Leases
Fiscal year ending 2007	\$ 11,041

Note 12 Prior Period Adjustment

The prior period adjustment of \$88,794 is to correct errors of recording sales and accounts receivable for prior periods where \$25,557 is related to the three months ended September 30, 2006 and \$63,237 is related to the year ended June 30, 2006. The \$25,557 error caused an overstatement of sales resulting in an understatement of net loss and deficit for the three months ended September 30, 2006, and an overstatement of accounts receivable as of September 30, 2006. The beginning balance of deficit for the current quarter has been restated in accordance with the recommendations of the Canadian Institute of Chartered Accountants with respect to Section 1506 "Accounting Changes" and "Prior Period Adjustments".

The prior period adjustment of \$63,237 is to correct an error of recording sales and accounts receivable for the year ended June 30, 2006. The error caused an overstatement of sales resulting in an understatement of net loss and deficit for the year ended June 30, 2006, and an overstatement of accounts receivable as of June 30, 2006. The deficit and accounts receivable as of June 30, 2006 as well as sales for the three and six months ended December 31, 2005 have been restated in accordance with the recommendations of the Canadian Institute of Chartered Accountants with respect to Section 1506 "Accounting Changes" and "Prior Period Adjustments".

Note 13 Subsequent Events

- a) On February 1, 2007, the Company announced that new equipment had been ordered to effectively double the size of its brewery located in Strawberry Hills, Surrey, British Columbia. The order included a bottling line and a canning line to be installed for a summer release of its products in the retail market.
- b) Subsequent to December 31, 2006, 250,000 warrants were exercised at \$0.30 per share and 725,000 warrants were exercised at \$0.50 per share.