

**RUSSELL BREWERIES INC.**  
**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2007**  
**(UNAUDITED)**

**RUSSELL BREWERIES INC.**  
**Management Discussion and Analysis**  
**For the three and six months ended December 31, 2007**

The following discussion and analysis prepared as of February 28, 2008 should be read in conjunction with the audited consolidated financial statements and related notes and Management Discussion and Analysis and for the fiscal year ended June 30, 2007 and 2006.

**FORWARD LOOKING STATEMENTS**

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

**OVERVIEW**

Through its wholly owned subsidiary, Russell Brewing Company Ltd., Russell Breweries Inc. ("the Company") operates a craft brewery based in Surrey, British Columbia. The Company produces premium draught beer for pubs and restaurants in British Columbia. The Company's operations include production facilities, corporate offices, storage facilities, brewing equipment, and delivery and sales vehicles. The brewery's main product lines are Russell Cream Ale, Russell Pale Ale, Russell Honey Blonde Ale, Russell Extra Special Lager, as well as two seasonal products, Russell Lemon Ale and Russell Christmas Ale.

The Company amalgamated with the Fort Garry Brewing Company Ltd. ("Fort Garry") of Winnipeg, Manitoba on October 22, 2007. Fort Garry is Manitoba's largest brewer and distributor of premium quality beers including Fort Garry Dark Ale, Fort Garry Pale Ale, Fort Garry Premium Light, Two Rivers Red and Stone Cold.

**BUSINESS DEVELOPMENTS AND SIGNIFICANT EVENTS**

In May 2007, the Company announced a three-year partnership agreement making Russell Brewing Company the Official Beer of the BC Lions and BC Place.

On July 27, 2007 the Company completed a unit private placement at \$0.60 for gross proceeds of \$3,176,500 netting to \$2,803,000 after cash commissions and issue costs. These proceeds were used to fund the Fort Garry acquisition, for capital expenditures and for general working capital – see Liquidity and Resources: Cash Flow.

On December 31, 2007 the Company entered into a secured loan with a shareholder of the Company whereby the Company received net proceeds of \$940,000 after a \$25,000 upfront bonus interest fee. Interest accrues on the loan amount at 8.5%, semi annual calculation and the term of the loan is for three years with principal and interest of \$1,239,000 payable at maturity. The Loan proceeds are for brewery operations, the launch of packaged products in British Columbia, capital expenditures, and for general working capital. The Company may repay the loan together with accrued interest at any time without penalty. The Company also issued 250,000 Warrants to the Lender, whereby each Warrant entitles the Lender to purchase one Russell common share at a price of \$0.65 per share expiring December 31, 2009 – see Liquidity and Resources: Cash Flow.

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**.BUSINESS DEVELOPMENTS AND SIGNIFICANT EVENTS continued**

On February 19, 2008 the Company launched the sale of cans, comprising 6 x 355 ml aluminum cans, into select private liquor stores located in British Columbia in the lower mainland, Whistler, Vancouver Island, Bowen Island and the Sunshine Coast.

**Acquisition of Fort Garry**

On May 25, 2007 the Company entered into a letter of intent with Fort Garry to purchase all of the common shares of the Fort Garry Brewing Company through a Plan of Amalgamation. On July 27, 2007, the Company completed a Definitive Agreement with Fort Garry. The shares of Fort Garry were de-listed effective October 22, 2007.

Effective October 22, 2007 the Company acquired all the issued common shares of Fort Garry Brewing Company Ltd for cash consideration of \$309,247 and equity consideration of \$2,353,998 equivalent shares of the Company's common stock at a fair market value of \$0.56 per share. In addition the Company paid cash consideration of \$953,726 to redeem the 4% cumulative preferred shares of Fort Garry including their par value and accrued redemption premium and accrued dividends. The transaction costs are \$468,811, which include 100,000 common shares of the Company allotted at a fair market value of \$0.46 as part of a corporate finance fee

The Fort Garry acquisition has been accounted for using the purchase method, with Russell Breweries Inc., as the acquirer and the assets and liabilities acquired recorded at their fair values as determined by an independent valuation. The results of Fort Garry's operations are included in the consolidated financial statements from October 23, 2007.

Acquired intangible assets at fair market value consist of brands and trademarks of \$1,773,283 and goodwill of \$439,340.

As management does not consider the resulting future income tax asset resulting from the allocation of the purchase price to be more likely than not to be recoverable, a valuation allowance has been provided for the full amount.

Management believes the merger will provide synergistic cost savings for the two companies and that it can grow the business of Fort Garry to utilize excess production capacity at the Fort Garry brewery. The combined companies will be able to serve all four western Canadian Provinces, namely British Columbia, Alberta, Saskatchewan and Manitoba.

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**Acquisition of Fort Garry (continued)**

<b>Acquisition of Fort Garry Brewing Company</b>		
<b>Allocation of Purchase Price to the Fair Value of Net Assets</b>		
Current assets	\$ 956,260	17%
Capital assets	2,459,926	44%
Intangible Assets	2,212,623	39%
<b>Fair Value of assets acquired</b>	<b>5,628,809</b>	<b>100%</b>
Current Liabilities	815,019	53%
Long term Current Liabilities	728,008	47%
<b>Fair Value of liabilities assumed</b>	<b>1,543,027</b>	<b>100%</b>
<b>Purchase Price</b>	<b>\$ 4,085,782</b>	

<b>Acquisition of Fort Garry Brewing Company</b>		
<b>Consideration given:</b>		
Cash for Fort Garry common shares and redemption of preferred shares	\$ 1,262,973	31%
4,203,566 Russell common shares for Fort Garry common shares	2,353,998	58%
<b>Consideration given to Fort Garry common and preferred shareholders</b>	<b>3,616,971</b>	<b>89%</b>
Transaction Costs	468,811	11%
<b>Purchase Price</b>	<b>\$ 4,085,782</b>	<b>100%</b>

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**SELECTED ANNUAL INFORMATION**

The following table presents selected financial information for the last three fiscal years ended June 30, 2007, 2006 and 2005:

	Year Ended 30-Jun-07	Year Ended 31-Jun-06	Year Ended 31-Jun-05
	Audited	Audited & restated	Audited
	\$	\$	\$
Net Sales	1,324,234	902,988	517,835
Earnings before interest and other income, taxes, depreciation and amortization*	(989,283)	(223,677)	(451,608)
Total income (loss) from continuing operations	(1,201,377)	(382,508)	(624,820)
Operating income (loss) per share	(0.09)	(0.04)	(0.10)
Net income (loss)	(1,201,377)	(382,508)	(624,820)
Basic and diluted earning (loss) per share	(0.09)	(0.04)	(0.10)
Total assets	2,795,597	1,018,436	944,822
Total long term financial liabilities	359,488	242,562	273,863
Cash dividends declared per share	Nil	Nil	Nil

\*. EBITDA means represents earnings before interest and other income, income taxes, depreciation and amortization. Management uses this measure to evaluate the operating results of the Company. EBITDA is a non-GAAP earnings measure, therefore it does not have any standardized meaning prescribed by Canadian generally accepted accounting principles and may not be similar to measures presented by other companies.

**SIGNIFICANT ACCOUNTING POLICIES**

The disclosures contained in the unaudited interim financial statements do not include all requirements of generally accepted accounting principles for annual financial statements. The unaudited interim financial statements should be read in conjunction with the annual financial statements for the year ended June 30, 2007. They follow the same accounting policies except as noted below.

Accountants ("CICA") Handbook section 1530, *Comprehensive Income*, CICA Handbook Section 3251, *Equity*, CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, CICA Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, and CICA Handbook Section 3865, *Hedges*. These new Handbook Sections, which apply to fiscal years beginning on or after October 1, 2006, provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. These new standards have been adopted on a prospective basis with no restatement of prior period amounts. The adoption of these policies has had no material effect on these financial statements.

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**SIGNIFICANT ACCOUNTING POLICIES (continued)**

Handbook Section 1530, Comprehensive Income, establishes standards for reporting and displaying comprehensive income. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

Handbook Section 3251, Equity, establishes standards for the presentation of equity and changes in equity during the reporting period and requires the Company to present separately components and changes in equity arising from i) net earnings; ii) other comprehensive income; iii) other changes in retained earnings; iv) changes in contributed surplus; v) changes in share capital; vi) changes in reserves.

Handbook Section 3855, Financial Instruments – Recognition and Measurement, establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. This standard requires all financial instruments within its scope, including derivatives, to be included on a Company's balance sheet and measured either at fair value or, in certain circumstances when fair value may not be considered most relevant, at cost or amortized to cost. Changes in fair value are to be recognized in the statement of operations and the statement of comprehensive income. All financial assets and liabilities are recognized when the entity becomes a party to the contract creating the item. As such, any of the Company's outstanding financial assets and liabilities at the effective date of adoption are recognized and measured in accordance with the new requirements as if these requirements had always been in effect. Any changes to the fair values of assets and liabilities prior to July 1, 2007 are recognized by adjusting opening deficit or opening accumulated other comprehensive income.

All financial instruments are classified into one of the following five categories: held for trading, held-to-maturity, loans and receivables, available-for-sale financial assets, or other financial liabilities. Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification:

- i) Held-to-maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period net earnings.
- ii) Available-for-sale financial assets are measured at fair value. Revaluation gains and losses are included in other comprehensive income until the asset is removed from the balance sheet.
- iii) Held for trading financial instruments are measured at fair value. All gains and losses are included in net earnings in the period in which they arise.
- iv) All derivative financial instruments are classified as held for trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. All gains and losses are included in net earnings in the period they arise.

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**PERFORMANCE AND RESULTS OF OPERATIONS**

**Prior Period restatement**

The prior period adjustment of \$25,557 is to correct errors of recording sales and accounts receivable for the period ended September 30, 2006. The errors caused overstatements of sales of \$25,557 resulting in understatements of net loss of \$25,557 and deficit of \$25,557 for the period ended September 30, 2006, as well as overstatements of accounts receivable of \$25,557 as of September 30, 2006. The result was to increase the reported net loss per share from \$0.013 to \$0.016 for the period ended September 30, 2006. The deficit and accounts receivable as of September 30, 2006 and sales for the period ended September 30, 2007 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".

**Reclassifications**

Certain 2007 figures have been reclassified to conform to the financial statement presentation adopted for the current three and six months ended 2007.

**Three months ended December 31, 2007 ("Q2 2008")**

The results of operations for the three months ended December 31, 2007 included the operation of Fort Garry from October 23, 2007.

See also Prior Period Restatement.

Net Sales for Q2 2008 were \$962,000 up \$702,000 or 270% compared to \$260,000 for the three months ended December 31, 2007 (Q2 2007). The sales increase is a result of the impact of the Company's newly acquired Fort Garry subsidiary ("Fort Garry") net sales contribution of \$575,000 and increased volume sales in Russell's British Columbia operating subsidiary Russell Brewing Company Ltd, from both new accounts and increased throughput from existing accounts compared to Q2 2007.

The gross margin for Q2 2008 was up \$376,000 or 211% to \$554,000 compared to \$178,000 for Q2 2007 as principally as a result of a \$309,000 gross margin contribution from Fort Garry. Overall gross margin percentage declined by 10% to 58% in Q 2 2008 from 68% in Q2 2007, as a result of the mix of lower margin Fort Garry product and higher raw material, freight costs and keg amortization in Russell Brewing Company.

Selling, general and administration expense for Q2 2008 increased \$328,000 or 64% to \$838,000 compared to \$510,000 for Q2 2007. Fort Garry contributed \$221,000 of the increase in expense. The significant increases in the operating subsidiary Russell Brewing Company and the holding company were labour expense increase of \$44,000 to \$144,000 compared to \$100,000 in Q2 2007, professional fees increase of \$47,000 to \$80,000 compared to \$33,000 in Q2 2007 (reflecting increased audit fee and other legal expenses), travel expense increase of \$33,000 to \$33,000 compared to \$nil in Q2 2007 and various other increases across most expense categories, reflecting the larger facilities and business operations compared to Q2 2007. Stock based compensation expense was \$nil in Q2 2008 compared to \$87,000 in Q2 2007. The Q2 2007 stock based compensation expense was of \$87,000 was the fair value expense calculated using the Black-Scholes method of issuing 760,000 incentive options at \$0.48.

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**PERFORMANCE AND RESULTS OF OPERATIONS**

**Three months ended December 31, 2007 ("Q2 2008") continued**

Other Items net expense grew \$227,000 or 668% to \$261,000 in Q2 2008 compared to \$34,000 in Q2 2007 principally as a result of the increase in amortization of \$208,000. The impact of Fort Garry's amortization contributed \$139,000 of this increase and Russell Brewing \$69,000 as a result of its increased capital asset base.

Net loss increased \$179,000 or 49% to \$546,000 for Q2 2008 or \$0.02 per share compared to the net loss of \$367,000 or \$0.03 for Q2 2007. Fort Garry operations contributed \$60,000 of Q2 2008 loss or \$0.00 loss per net share.

**Six months ended December 31, 2007 ("2008 YTD")**

Net Sales YTD 2008 increased \$889,000 or 169% to \$1,414,000 compared to \$525,000 for YTD 2007. The sales increase is a result of the impact of the Company's newly acquired Fort Garry subsidiary ("Fort Garry") net sales contribution of \$575,000 and increased volume sales in Russell's British Columbia operating subsidiary Russell Brewing Company Ltd, from both new accounts and increased throughput from existing accounts compared to YTD 2007 including the impact of the British Columbia Lions and BC Place contract largely in Q1 of 2008.

The gross margin for YTD 2008 increased \$533,000 or 142% to \$907,000 compared to \$374,000 for YTD 2007 principally as a result of a \$309,000 gross margin contribution from Fort Garry and increased net sales from Russell Brewing Company. Overall gross margin percentage declined by 7% to 64% YTD 2008 from 71% YTD 2007, as a result of the mix of lower margin Fort Garry product and overall higher raw material costs, freight and keg amortization costs in Russell Brewing Company.

Selling, general and administration expense for YTD 2008 increased \$957,000 or 116% to \$1,780,632 compared to \$824,000 for YTD 2007. Fort Garry contributed \$221,000 of the increase in expense. The significant increases in the operating subsidiary Russell Brewing Company and the Company were advertising and promotion expense increased \$222,000 to \$416,000 compared to \$194,000 YTD 2007 due to promotions associated with increasing brand awareness and expensing most of the new 3 year BC Lions and BC Place sponsorship fee in YTD the period, labour expense increase of \$111,000 to \$311,000 compared to \$200,000 for YTD 2007, professional fees increase of \$73,000 to \$113,000 compared to \$40,000 for YTD 2007 reflecting increased audit fee and other legal expenses, and various other increases across most expense categories, reflecting the larger facilities and business operations and travel compared to YTD 2007. Stock based compensation expense increased \$194,000 to \$281,000 for YTD 2008 compared to \$87,000 for YTD 2007.

Stock based compensation expense results from calculating the fair value using the Black-Scholes method of the grant of 690,000 incentive stock options at \$0.55 for 5 years as follows, 400,000 incentive stock options to a financial consultant of the Company, 150,000 incentive stock options to the in house investor relations consultant appointed end of August, 2007 and 70,000 incentive to each of two directors in their capacity as Chief Executive Officer, and President and Chief Financial Officer. The 2007 YTD expense of \$87,000 was the fair value expense of issuing 760,000 incentive options at \$0.48.

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**PERFORMANCE AND RESULTS OF OPERATIONS**  
**Six months ended December 31, 2007 (“2008 YTD”)**

Other Items net expense grew \$267,000 or 351% to \$343,000 for YTD 2008 compared to \$76,000 for YTD 2007, principally as a result of the increase in amortization of \$261,000. The impact of Fort Garry’s amortization contributed \$139,000 of this increase and Russell Brewing Company \$122,000 as a result of Russell Brewing Company’s bigger capital asset base.

Net loss increased \$691,000 or 131% to \$1,217,000 for YTD 2008 or \$0.05 per share compared to the net loss of \$526,000 or \$0.04 for YTD 2007. Fort Garry operations contributed \$60,000 of YTD 2008 loss or \$0.00 loss per net share.

**Summary of Quarterly Results**

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

Fiscal Year	2008	2008	2007	2007	2007	2007	2006	2006
Quarter	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
						Restated	Restated	Restated
		\$	\$	\$	\$		\$	\$
Net revenues	961,663	452,465	460,149	338,969	259,753	265,363	277,255	182,487
EBITDA*	(284,585)	(589,199)	(422,468)	(121,989)	(330,739)	(114,087)	(89,191)	(100,517)
Net loss	(545,816)	(671,068)	(505,553)	(170,068)	(366,898)	(158,858)	(125,978)	(142,870)
Net loss per share	(0.02)	(0.03)	(0.03)	(0.01)	(0.03)	(0.02)	(0.01)	(0.01)

\*. EBITDA means represents earnings before interest and other income, income taxes, depreciation and amortization. Management uses this measure to evaluate the operating results of the Company. EBITDA is a non-GAAP earnings measure, therefore it does not have any standardized meaning prescribed by Canadian generally accepted accounting principles and may not be similar to measures presented by other companies.

Q4 (3 months ended June 30) is traditionally the seasonally strongest quarter followed by Q1 (3 months ended September 30) reflecting the strongest beer sales in the warmer spring and summer months.

Q2 2008 includes the results of the Company’s Fort Garry operations from October 23, 2007 to December 31, 2007 of net sales of \$575,000, EBITDA of \$88,000 and of Net Loss of (\$60,000). The Company’s British Columbia operations show sales growth for each comparative prior year fiscal quarter, reflecting increasing sales volume to new accounts, including the BC Lions and BC Place contract whose main impact is in Q1 2008, as well as volume through put to existing accounts and some improvement in selling price due to mix of keg sizes. Q1 2007 onward reflects the lower federal excise tax structure over periods prior to that.

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**Summary of Quarterly Results (continued)**

Stock based compensation can materially impact quarterly loss results. Stock based compensation expense was \$280,800 in Q1 2008, \$257,215 in Q4 2007, \$86,976 in Q2 2007 and a credit of \$15,696 in Q4 2006. Advertising and marketing expenditures to position brand and support sales can also materially impact quarterly results, namely expense of \$271,228 in Q 1 2008 which includes a significant pro rata portion of the new BC Lions / BC place contract as well increase in continued branding promotion and \$161,642 in Q4 2007 compared to only \$63,080 expense in Q 4 2006.

**LIQUIDITY AND CAPITAL RESOURCES**

**Financial condition**

At December 31, 2007, the Company has net working capital of \$1,807,000 including cash and equivalents of \$1,340,000, short term investments of \$354,000 and bank indebtedness of \$181,787. The Company has \$200,000 of restricted cash securing \$100,000 of bank indebtedness and \$100,000 of capital leases. Long term debt is \$1,639,000. Included in long term debt and current portion of long term debt is a new three year secured shareholder loan to the Company entered into on December 31, 2007 for \$965,000 less upfront interest of \$25,000; and \$93,000 of term loan with Bank of Nova Scotia; and \$881,000 of term loan with the Business Development Bank of Canada in the Fort Garry subsidiary.

The Company has neither a history of earnings nor has it paid any dividends and it is unlikely to pay dividends or enjoy earnings in the immediate or foreseeable future. The Company accumulated losses from inception of \$3,674,616 to December 31, 2007.

Funds on hand are estimated as sufficient to fund the Company's expected operating losses and planned non discretionary capital expenditures for the next twelve months. The Company will seek additional cash in the equity and / or debt markets as the need arises. There is no guarantee that the Company will be able to raise additional equity or debt financing or generate cash flow from operations in the future

**Cash flow**

**Q2 2008**

Net cash used by operating activities in Q2 2008 was \$436,000 compared to use of \$518,000 in Q2 2007, a decrease in use of \$82,000. Net cash used in operations comprised: net loss of \$546,000 compared to net loss of \$367,000 in Q2 2007, a \$179,000 increase in use; non-cash items comprised of amortization of \$241,000 in Q2 2008 compared to \$33,000 in Q2 2007 and stock based compensation expense adjustment of \$nil in Q2 2008 compared to \$87,000 in Q2 2007, a \$121,000 decrease in net use; and non cash working items use of \$130,000 in Q2 2008 compared to \$ 271,000 in Q 2 2007, a \$140,000 decrease in use.

Investing activities in Q 2 2008 were \$1,358,000, comprising cash portion of Fort Garry acquisition net of cash acquired \$1,483,000, finance from deferred costs of \$260,000, the purchase of capital assets of \$133, 000 and short tem investments of \$2,000. Investing activities in Q2 2077 comprised purchase of capital assets \$49,000.

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**LIQUIDITY AND CAPITAL RESOURCES**

**Cash flow - Q2 2008 (continued)**

The Company completed its acquisition of Fort Garry effective October 22, 2007.— see Business Developments and significant events: Fort Garry Acquisition.

During Q2 2008 the Company received \$950,000 from financing activities, comprising loans net of repayments and up-front interest of \$890,000, share capital proceeds from the exercise of warrants of \$144,000, less net capital lease repayments of \$75,000 and demand loan repayments of \$9,000. Q2 2007 financing activities were \$1,359,000 principally \$1,353,000 were from a unit financing at \$0.30.

The Company entered into a shareholder loan on December 31, 2007 for loan amount of \$965,000 less a \$25,000 upfront bonus fee. The Loan proceeds are for brewery operations, the launch of packaged products in British Columbia, capital expenditures, miscellaneous expenditures, and for general working capital. Interest accrues on the loan amount at 8.5%, semi annual calculation. Principal and interest repayable at maturity is \$1,239,000. The term of the Loan is three years. The Company may repay the Loan at any time without penalty by paying the loan amount of \$965,000 together with any accumulated interest. The Company also issued 250,000 Warrants to the Lender, whereby each Warrant entitles the Lender to purchase one Russell common share at a price of \$0.65 per share expiring December 31, 2009. Any shares issued upon exercise of the Warrants are subject to a hold period expiring May 1st, 2008.

The Loan is guaranteed by Russell Brewery Company Ltd. and Fort Garry Brewing Ltd., both wholly-owned subsidiaries of Russell. As security for the Loan, Russell, RBCL, and Fort Garry granted 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 capital lease obligations incurred for future acquisitions of equipment and other capital assets.

**YTD 2008**

Net cash used by operating activities YTD 2008 was \$569,000 compared to \$436,000 in YTD 2007 an increase in use of \$133,000. Net cash used in operations comprised: net loss of \$1,217,000 compared to net loss of \$526,000 YTD 2007, a \$691,000 increase in use; non-cash items comprised of amortization of \$328,000 YTD 2008 compared to \$67,000 YTD 2007 and stock based compensation expense Q2 YTD of \$281,000 compared to \$87,000 YTD 2007, a \$455,000 decrease in net use; and non cash working items source of \$39,000 YTD 2008 compared to \$64,000 YTD 2007 use, a \$103,000 decrease increase in use.

On October 22, 2008 the Company completed its acquisition of Fort Garry and the purchase of the Fort Garry preferred shares for a cash component of \$1,263,000. The cash component of transaction costs is \$423,000 – see Business Developments and significant events: Fort Garry Acquisition.

During YTD 2008 the Company received \$3,758,000 from financing activities, comprising loans net of repayments and up-front interest of \$878,000 (see shareholder loan note Q2 2008 above); share capital proceeds of \$3,001,000, comprising \$2,803,000 net proceeds of a private placement (see below) and the exercise of warrants of \$198,000; less net capital lease repayments of \$102,000 and demand loan repayments of \$19,000. YTD 2007 financing activities were primarily shares issued for cash of \$1,359,000, principally a \$1,353,000 unit financing at \$0.30.

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**LIQUIDITY AND CAPITAL RESOURCES**

**Cash flow – YTD 2008 (continued)**

On July 27, 2007 the Company completed a \$3,176,000 gross proceeds private placement to net \$2,803,000 after \$373,000 of Agent's commissions and cash costs of the Offering. The Company issued 5,294,166 Units at a price of \$0.60 per Unit, with each Unit consisting of one common share and one non-transferable common share purchase Warrant. Each whole Warrant entitles the holder to purchase one additional share of the Company at a price of \$0.75 per share for a period of one year from the completion of the financing subject to a warrant exercise acceleration clause. The proceeds were used for the acquisition of Fort Garry, capital equipment and for general working capital.

The Agents received a cash commission of \$245,782 and 13,896 units (8% of the gross proceeds). In addition, the Agents were granted 529,417 agent's warrants (the "Agent's Warrant") exercisable for a period of one year from the date of closing of the Offering. Each Agent's Warrant is exercisable into one (1) common share of the Company at \$0.60 per share and will also be subject to early expiry conditions. In addition, the Agents were paid an administrative fee of \$5,000, a Corporate Finance Fee of 50,000 units, and were reimbursed for all reasonable expenses related to the Offering. .

**RELATED PARTIES**

Russell Breweries Inc.'s Board of Directors consists of Brian Harris, CEO, Andrew Harris, President and Chief Financial Officer, John Morgan Chairman, Rick Shier and Tom Maroon.

During Q2 2008 and YTD 2008, the Company paid or accrued management fees, salary and consulting fees to related parties as follows:

Brian Harris in his capacity as Chief Executive Officer Q2 2008 \$15,000, YTD 2008 \$30,000 (Q2 2007: \$12,000; YTD 2007 \$24,000).

Andrew Harris in his capacity as President and Chief Financial Office Q2 2008 \$15,000, YTD 2008 \$31,550 (Q2 2007: \$12,000; YTD \$24,000).

Paul Harris in his capacity as Chief Brew Master Q2 2008 \$12,500, YTD \$19,167 (Q2 2007: \$10,834, YTD 2007 \$18,337).

Peter Harris in his capacity as Manager of Operations Q2 2008 \$18,500, YTD 2008 \$30,167 (Q2 2007 \$11,418; YTD 2007 18,503).

Angela Fernandes (formerly Harris) in her capacity as Manager of Marketing Q2 2008 \$10,350, YTD \$20,700 (Q2 2007: \$10,350, YTD 2007 \$19,350).

Wendy Harris for contracted labour Q2 2008 \$1,000, YTD \$1,000) (Q2 and YTD 2007 \$nil)

Mr. Brian Harris is the father of Andrew Harris, Paul Harris, Peter Harris and Angela Fernandes and husband of Wendy Harris.

Mr. John Morgan, a director of the Company was paid \$12,000 in Q2 2008, YTD \$24,000 (Q2 2007: \$16,000, YTD 2007 \$28,000) for business development services.

Heather Morgan, daughter of John Morgan was paid \$11,554 for contracted services in Q2 2008, YTD 2008 \$11,554 (Q2 and YTD 2007 \$nil).

There are no current contracts of employment in place for any of the above noted parties.

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**CRITICAL ACCOUNTING ESTIMATES**

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.

**Returnable Containers**

Returnable containers are recorded at cost and are amortized over their estimated useful lives. There is uncertainty in these estimates in that actual experience may vary from these estimates.

**Capital Assets**

Capital assets are originally recorded at cost. Property acquired under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of the fair value of the property or equipment and the present value of those lease payments. Depreciation is calculated on the declining balance basis. There is uncertainty in these estimates in that actual experience may vary from these estimates.

**Future Income Tax Asset**

The Company has not recorded an income tax asset. The Company has determined it has not met the "more likely than not test" required by the CICA Handbook section 3465 "Income Taxes" for these assets to be recorded.

**Stock-based Compensation Plans**

The Company recognizes compensation expense on options granted to employees, consultants and directors under its option plan. Stock based compensation expense recognized during Q2 was \$nil and \$281,000 2008 YTD (Q2 2007 \$87,000, YTD 2007 \$87,000). Assumptions regarding expected stock volatility and risk free interest rates are required to calculate the fair value of the consideration received.

**RUSSELL BREWERIES INC.**  
**Management Discussion and Analysis**  
**For the three and six months ended December 31, 2007**

**OUTSTANDING SHARE DATA**

The Authorized share capital consists of 400,000,000 common shares without par value.

Outstanding Share Data	Number of Common Shares	Exercise (\$) Price per common share	Expiry Dates
Issued and outstanding as at February 28, 2008	26,660,348*	N/A	N/A
Stock Options	2,165,000	\$0.33 - \$0.55	April 13, 2011 – August 29, 2012
Agent and subscriber warrants	10,360,894	\$0.30 - \$0.75	July 27, 2008** – December 31, 2009***
Fully Diluted as at February 5, 2008	39,186,242	N/A	N/A

\*Of which 220,500 shares of the Company are subject to an Escrow Agreement to be released May 2, 2008.

\*\* the Issuer's shares trading at or above a weighted average trading price of \$1.00 for 15 consecutive days the Issuer may give notice that the Warrants will expire 30 days from the date of providing such notice.

\*\*\*the Issuer's shares trading at or above a weighted average trading price of \$0.75 for 20 consecutive days the Issuer may give notice that the Warrants will expire 30 days from the date of providing such notice.

**RISKS AND UNCERTAINTIES**

**Credit risk**

The Company grants credit to its customers in the normal course of business. However as the major portion of the accounts receivable is the British Columbia Liquor Distribution Branch, management believes exposure to credit risk is limited.

**Business Risk**

There are certain inherent risks in the Company's operation that may impact financial results in the future. The most significant risks are as follows:

The Company operates in an environment that is highly competitive and government related. The effects of such competition and regulation may significantly impact financial results in the future.

The Company is reliant on receiving various permits, licenses and approvals from several government agencies to operate in its market areas. The company believes it is compliance with all permits, licenses and approvals.

**RUSSELL BREWERIES INC.**  
**Management Discussion and Analysis**  
**For the three and six months ended December 31, 2007**

**RISKS AND UNCERTAINTIES (continued)**

**Disclosure Controls and Procedures**

Management has designed internal disclosure controls and procedures over disclosure controls and procedures and financial reporting appropriate for the nature and size of its operations to provide reasonable assurance regarding reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The Company did not make any change in its internal control over financial reporting during the three months ended September 30, 2007.

Management has identified certain weaknesses in internal controls over financial reporting as follows:

- 1) Due to a limited number of accounting and administrative staff, it is not feasible to achieve complete segregation of duties.

**RISKS AND UNCERTAINTIES**

**Disclosure Controls and Procedures continued**

- 2) Due to a limited number of staff the Company does not have sufficient finance personnel with appropriate technical accounting knowledge to address all complex and non-routine transactions that may arise.

**INVESTOR RELATIONS**

The Company hired an in-house investor relations consultant August 2007.

**ADDITIONAL INFORMATION**

Additional information relating to Russell Breweries Inc. is located at [www.sedar.com](http://www.sedar.com) and [www.russellbeer.com](http://www.russellbeer.com). or contact Brian Harris, Russell Breweries Inc., 13018 80 Avenue, Surrey, BC V3W 3B2 ,Telephone: (604) 599-1190 Facsimile: (604) 599-1048

**RUSSELL BREWERIES INC.  
INTERIM CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)**

December 31,  
2007

June 30,  
2007

**ASSETS**

<b>CURRENT</b>		
Cash and cash equivalents	\$ 1,339,802	\$ 140,628
Short-term investments	354,146	402,781
Accounts receivable	788,808	409,606
Inventory	707,179	332,780
Prepaid expenses and deposits	87,982	263,092
	3,277,917	1,548,887
<b>RESTRICTED CASH</b>	200,000	200,000
<b>CAPITAL ASSETS</b>	3,626,003	903,903
<b>BRANDS AND TRADEMARKS (Note 3)</b>	1,775,083	1,800
<b>DEFERRED COSTS</b>	57,355	141,007
<b>GOODWILL (Note 3)</b>	439,340	-
	\$ 9,375,698	\$ 2,795,597

**LIABILITIES**

<b>CURRENT</b>		
Bank indebtedness	\$ 181,787	\$ 376,841
Demand bank loan	5,517	24,267
Accounts payable and accrued liabilities	690,221	428,375
Refundable deposits	198,980	-
Due to related parties (Note 7)	-	1,945
Current portion of long-term debt (Note 4)	275,004	50,004
Current portion of obligations under capital leases	119,522	142,806
	1,471,031	1,024,238
<b>LONG-TERM DEBT (Note 4)</b>	1,639,219	67,694
<b>OBLIGATIONS UNDER CAPITAL LEASES</b>	358,135	291,794
	3,468,385	1,383,726

**SHAREHOLDERS' EQUITY**

<b>SHARE CAPITAL (Note 5)</b>	8,158,621	2,794,158
<b>CONTRIBUTED SURPLUS (Note 5)</b>	1,423,336	1,075,743
<b>DEFICIT</b>	(3,674,644)	(2,457,760)
	5,907,313	1,411,871
	\$ 9,375,698	\$ 2,795,597

Approved on behalf of the Board:

/s/ Andrew Harris  
Andrew Harris – Director

/s/ Brian Harris  
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**  
**(UNAUDITED)**

	Three Months Ended December 31, 2007	Three Months Ended December 31, 2006 <i>(Restated – Note 8)</i>	Six Months Ended December 31, 2007	Six Months Ended December 31, 2006 <i>(Restated – Note 8)</i>
<b>SALES</b>	\$ 1,165,227	\$ 349,657	\$ 1,799,439	\$ 735,913
Less excise tax and provincial mark-up	203,564	89,904	385,311	210,797
<b>NET REVENUE</b>	961,663	259,753	1,414,128	525,116
<b>COST OF SALES</b>	407,951	82,287	507,280	151,170
<b>GROSS MARGIN</b>	553,712	177,466	906,848	373,946
<b>EXPENSES</b>				
Selling, general and administrative	838,297	510,605	1,780,632	823,572
	838,297	510,605	1,780,632	823,572
<b>LOSS BEFORE THE UNDERNOTED</b>	284,585	333,139	873,784	449,626
<b>OTHER (INCOME) / EXPENSES</b>				
Amortization	240,871	33,190	327,797	66,825
Interest on long-term debt	35,294	9,603	53,155	18,339
Interest and other income	(14,934)	(9,034)	(37,852)	(9,034)
	261,231	33,759	343,100	76,130
<b>NET LOSS FOR THE PERIOD</b>	545,816	366,898	1,216,884	525,756
<b>DEFICIT, BEGINNING OF THE PERIOD</b>				
As previously reported	3,128,828	1,326,447	2,457,760	1,193,146
Prior period adjustment (Note 8)	-	88,794	-	63,237
Deficit, as restated	3,128,828	1,415,241	2,457,760	1,256,383
<b>DEFICIT, END OF THE PERIOD</b>	\$ 3,674,644	\$ 1,782,139	\$ 3,674,644	\$ 1,782,139
<b>LOSS PER SHARE – Basic and diluted</b>	\$ 0.02	\$ 0.03	\$ 0.05	\$ 0.04
Weighted average number of shares outstanding	24,686,061	14,456,918	22,463,174	12,239,526

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

**RUSSELL BREWERIES INC.**  
**INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	Three Months Ended December 31, 2007	Three Months Ended December 31, 2006	Six Months Ended December 31, 2007	Six Months Ended December 31, 2006
		<i>(Restated – Note 6)</i>		<i>(Restated – Note 6)</i>
<b>CASH FLOWS PROVIDED BY (USED FOR):</b>				
<b>OPERATING ACTIVITIES</b>				
Net loss for the year	\$ (545,816)	\$ (366,898)	\$ (1,216,884)	\$ (525,756)
Adjusted for non-cash items:				
Amortization	240,871	33,190	327,797	66,825
Stock based compensation expenses	-	86,976	280,800	86,976
	(304,945)	(246,732)	(608,287)	(371,955)
Net changes in non-cash working capital items:				
Accounts receivable	(135,391)	(129,443)	(32,965)	(14,850)
Prepaid expenses and deposits	110,824	2,652	239,904	5,662
Inventory	35,526	(16,359)	(737)	(18,300)
Accounts payable and accrued liabilities	(128,696)	(55,016)	(116,237)	24,848
Refundable deposits	(12,956)	-	(12,956)	-
Due to and from related parties	(260)	(73,005)	(1,945)	(61,701)
	(435,898)	(517,903)	(533,223)	(436,296)
<b>INVESTING ACTIVITIES</b>				
Short-term investments	(2,073)	-	48,635	-
Deferred costs	260,177	-	110,608	-
Purchase of capital assets	(132,964)	(49,374)	(506,365)	(53,955)
Cash portion of business acquisition, net of cash acquired	(1,483,349)	-	(1,483,349)	-
Restricted cash	-	-	-	(100,000)
	(1,358,209)	(49,374)	(1,830,471)	(153,955)
<b>FINANCING ACTIVITIES</b>				
Loan, net of repayments and up-front interest	890,276	(16,703)	877,775	(29,204)
Capital lease repayments	(74,814)	(7,484)	(102,631)	(14,639)
Demand loan repayments	(9,375)	(9,375)	(18,750)	(20,529)
Share capital issued for cash	143,517	1,358,500	3,001,528	1,358,500
	949,604	1,324,938	3,757,922	1,294,128
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(844,503)	757,661	1,394,228	703,877
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	2,002,518	(87,905)	(236,213)	(34,121)
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	\$ 1,158,015	\$ 669,756	\$ 1,158,015	\$ 669,756
<b>CASH AND CASH EQUIVALENTS CONSIST OF:</b>				
Cash	\$ 151,806	\$ 12,652	\$ 151,806	\$ 12,652
Bank Indebtedness	(181,787)	(179,770)	(181,787)	(179,770)
Bankers Acceptance and Term Deposits	1,187,996	836,874	1,187,996	836,874
	\$ 1,158,015	\$ 669,756	\$ 1,158,015	\$ 669,756
<b>Supplemental Cash Flow Information</b>				
Interest paid	\$ 60,294	\$ 9,603	\$ 78,155	\$ 18,339
Income taxes paid	\$ -	\$ -	\$ -	\$ -

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

**RUSSELL BREWERIES INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**DECEMBER 31, 2007**

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**NOTE 1 - NATURE OF OPERATIONS**

The Company was incorporated under the British Columbia Company Act on March 23, 2000. The Company operates a craft brewery based in Surrey, British Columbia, Canada. On October 22, 2007 the Company, acquired by way of amalgamation, the Fort Garry Brewing Company Ltd. ("Fort Garry") that operates a craft brewery in Winnipeg, Manitoba, Canada. Refer to Notes 3 and 5. The Company's shares are traded on the TSX Venture Exchange.

The Company has neither a history of earnings nor has it paid any dividends and it is unlikely to pay dividends or enjoy earnings in the immediate or foreseeable future. At December 31, 2007, the Company has working capital of \$1,806,886 and has accumulated losses from inception of \$3,674,616. The continuation of the Company as a going concern is dependent upon the continued financial support from its shareholders, the ability of the Company to obtain necessary equity financing to continue operations and to generate sustainable significant revenue. There is no guarantee that the Company will be able to raise any equity financing or generate profitable operations. These financial statements do not include any adjustments to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. These factors raise substantial doubt regarding the Company's ability to continue as a going concern.

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES**

**Changes in Accounting Policies**

The disclosures contained in the unaudited interim financial statements do not include all requirements of generally accepted accounting principles for annual financial statements. The unaudited interim financial statements should be read in conjunction with the annual financial statements for the year ended June 30, 2007. They follow the same accounting policies except as noted below.

Effective July 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook section 1530, *Comprehensive Income*, CICA Handbook Section 3251, *Equity*, CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, CICA Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, and CICA Handbook Section 3865, *Hedges*. These new Handbook Sections, which apply to fiscal years beginning on or after October 1, 2006, provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. These new standards have been adopted on a prospective basis with no restatement of prior period amounts. The adoption of these policies have had no material effect on these financial statements.

Handbook Section 1530, *Comprehensive Income*, establishes standards for reporting and displaying comprehensive income. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

Handbook Section 3251, *Equity*, establishes standards for the presentation of equity and changes in equity during the reporting period and requires the Company to present separately components and changes in equity arising from i) net earnings; ii) other comprehensive income; iii) other changes in retained earnings; iv) changes in contributed surplus; v) changes in share capital; vi) changes in reserves.

Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. This standard requires all financial instruments within its scope, including derivatives, to be included on a Company's balance sheet and measured either at fair value or, in certain circumstances when fair value may not be considered most relevant, at cost or amortized to cost. Changes in fair value are to be recognized in the statement of operations and the statement of comprehensive income. All financial assets and liabilities are recognized when the entity becomes a party to the contract creating the item. As such, any of the Company's outstanding financial assets and liabilities at the effective date of adoption are recognized and measured in accordance with the new requirements as if these requirements had always been in effect. Any changes to the fair values of assets and liabilities prior to July 1, 2007 are recognized by adjusting opening deficit or opening accumulated other comprehensive income.

All financial instruments are classified into one of the following five categories: held for trading, held-to-maturity, loans and receivables, available-for-sale financial assets, or other financial liabilities. Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification:

- i) Held-to-maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period net earnings.

**RUSSELL BREWERIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**DECEMBER 31, 2007**

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**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

- ii) Available-for-sale financial assets are measured at fair value. Revaluation gains and losses are included in other comprehensive income until the asset is removed from the balance sheet.
- iii) Held for trading financial instruments are measured at fair value. All gains and losses are included in net earnings in the period in which they arise.
- iv) All derivative financial instruments are classified as held for trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. All gains and losses are included in net earnings in the period they arise.

**NOTE 3 – BUSINESS ACQUISITION**

Effective October 22, 2007 the Company acquired all the issued common shares of Fort Garry Brewing Company Ltd for cash consideration of \$309,247 and equity consideration of \$2,353,998 equivalent shares of the Company's common stock at a fair market value of \$0.56 per share. In addition the Company paid cash consideration of \$953,726 to redeem the 4% cumulative preferred shares of Fort Garry including their par value and accrued redemption premium and accrued dividends. The transaction costs are \$468,811, which include 100,000 common shares of the Company allotted at a fair market value of \$0.46 as part of a corporate finance fee.

The Fort Garry acquisition has been accounted for using the purchase method, with Russell Breweries Inc., as the acquirer and the assets and liabilities acquired recorded at their fair values as determined by an independent valuation. Fort Garry's results of operations are included in these consolidated financial statements from October 23, 2007. The comparative figures for the consolidated balance sheets presented as at June 30, 2007 and the comparative figures for the statements of loss and deficit and cash flows for the three and six months ended December 31, 2006 do not include Fort Garry.

As management does not consider the resulting future income tax asset resulting from the allocation of the purchase price to be more likely than not to be recoverable, a valuation allowance has been provided for the full amount.

**Fair values of net assets acquired:**

Cash	\$ 202,435
Accounts Receivable	346,237
Inventory	342,794
Prepaid Expenses And Deposits	64,794
	956,260
Capital Assets	2,459,926
Intangible Assets: Brands and Trademarks	1,773,283
Goodwill	439,340
	5,628,809
Accounts Payable And Accrued Liabilities	(407,406)
Refundable deposits	(182,613)
Current Portion Of Long-Term Debt	(225,000)
	4,813,790
Long Term Debt	(693,750)
Obligations Under Capital Leases	(34,258)
	\$ 4,085,782

**Consideration given:**

Issuance of 4,203,566 common shares of Russell	\$ 2,353,998
Cash payment	309,247
Redemption of Fort Garry preferred shares	953,726
Transaction Costs	468,811
	\$4,085,782

**RUSSELL BREWERIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**DECEMBER 31, 2007**

**NOTE 4 – LONG TERM DEBT**

	December 31, 2007	June, 30 2007
<u><i>Bank of Nova Scotia Loan</i></u>	\$ 92,696	\$ 117,698
Loan payable, maturing December 2010, with principal repayments of \$4,167 per month commencing January 2005, plus interest at the bank prime rate plus 2.5%. 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 Bank of Nova Scotia, as well as a personal guarantee of a director in the amount of \$62,500.		
<u><i>Business Development Bank of Canada loan</i></u>	\$881,250	-
Loan payable, maturing November 2009, with principal repayments of \$18,750 per month commencing November 2005, plus interest at 7.78%. The loan is secured by security interests in all of Fort Garry, the Company's subsidiary, present and future acquired personal property subject to postponement and subordination to the security held by the Bank of Nova Scotia with respect to a line of credit provided to Fort Garry.		
<u><i>Loan Advance<sup>(1)</sup></i></u>	\$965,000	-
Loan advance payable, maturing December 31, 2010, with repayment of the principal amount \$965,000 at maturity, plus accumulated interest at 8.5% calculated semi-annually. The Loan is secured by a subordinated security agreement creating a security interest and charge over all of Russell Breweries Company Ltd. and Fort Garry Brewing Company Ltd., both wholly-owned subsidiaries of the Company, respective property and assets subordinate to senior debt and senior security of up to \$2.5 million plus capital lease obligations incurred for future acquisitions of equipment and other capital assets.		
	1,938,946	117,698
Add accumulated interest	254	-
Less		
Deferred interest	(24,977)	-
Current portion	(275,004)	(50,004)
	\$ 1,639,219	\$ 67,694

Future principal repayments are as follows:

Fiscal year ending 2008	137,502
Fiscal year ending 2009	275,004
Fiscal year ending 2010	242,690
Fiscal year ending 2011	1,190,000
Fiscal year ending 2012	93,750
	\$1,938,946

- (1) On December 31, 2007, the Company entered into a loan agreement (the "Loan Agreement") pursuant to which the "Lender", a shareholder of the Company, provided to the Company a loan (the "Loan") valued at maturity in the amount of \$1,239,000. A discounted value or Loan advance amount of \$965,000 is calculated based on an 8.5% per annum interest rate, calculated semi-annually, with interest payable on maturity resulting in a total loan value at maturity of \$1,239,000. In consideration of the Lender agreeing to provide the Loan, the Lender earned a bonus of \$25,000 deducted from the Loan advance amount for a net advance to Russell of \$940,000. The term of the Loan is three years. The Company may repay the Loan at any time without penalty by paying the discounted Loan advance amount of \$965,000 together with accumulated interest.

The Loan is guaranteed by Russell Breweries Company Ltd. ("RBCL") and Fort Garry Brewing Company Ltd. ("Fort Garry"), both wholly-owned subsidiaries of the Company. The Company intends to repay the Loan by utilizing cash flow or by a debt or equity refinancing.

The Company intends to use the proceeds of the Loan for its brewery operations, the launch of packaged products in British Columbia, capital expenditures, miscellaneous expenditures and for general working capital.

**NOTE 4 – LONG TERM DEBT (CONTINUED)**

**RUSSELL BREWERIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**DECEMBER 31, 2007**

As security for the Loan, Russell, RBCL, and Fort Garry will grant to the Lender a subordinated security agreement creating a security interest and charge over all of their respective property and assets subordinate to senior debt and senior security of up to \$2.5 million plus capital lease obligations incurred for future acquisitions of equipment and other capital assets.

As a bonus, Russell issued 250,000 warrants (the "Warrants") to the Lender, each warrant entitling the holder to purchase one Russell common share at a price of \$0.65 per share. The Warrants will expire two years after the date of issuance. The Warrants and any shares issued upon exercise of the Warrants are subject to a hold period of four months plus one day from the date of issuance of the Warrants.

**.NOTE 5 - SHARE CAPITAL**

a) Authorized

The Company's authorized share capital consists of 400,000,000 common shares without par value.

b) Issued

	Common Shares		Value		Contributed Surplus
Issued at June 30, 2006	10,022,135	\$	1,371,365	\$	249,282
Stock-based compensation	-		-		344,191
Agent's warrants	-		(482,000)		482,000
Corporate finance fee	100,000		30,000		-
Non cash issue costs	-		(30,000)		-
For cash:					
Private placement	5,000,000		1,500,000		-
Share issue costs	-		(146,500)		-
Exercise of warrants	1,216,085		551,293		-
Issued at June 30, 2007	16,338,220	\$	2,794,158	\$	1,075,473
Loan warrants					30,000
Stock-based compensation	-		-		280,800
Agent's warrants	-		(37,063)		37,063
Corporate finance fee shares	50,000		30,000		-
Commission shares	13,896		8,338		-
Non cash issue costs	-		(38,338)		-
Acquisition of Fort Garry by way of issuance of common shares	4,203,566		2,353,998		-
For cash:					
Private placement	5,294,166		3,176,500		-
Share issue costs	-		(373,122)		-
Exercise of warrants	660,500		198,150		-
Issued at December 31, 2007	26,560,348		\$8,112,621		\$1,423,336
Allotted but un-issued	100,000		46,000		-
	<u>26,660,348</u>		<u>\$8,158,621</u>		<u>\$1,423,336</u>

**RUSSELL BREWERIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**DECEMBER 31, 2007**

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**NOTE 5 - SHARE CAPITAL (CONTINUED)**

c) Escrow Shares

At December 31, 2007, 220,500 (2006: 882,000) common shares issued are held in escrow and will be released on May 2, 2008.

d) Private Placement

In July 2007, the Company closed a brokered private placement of 5,294,166 units at a price of \$0.60 per unit for total proceeds of \$3,176,500, net proceeds of \$2,803,378. 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 \$0.75 for a period of one year from completion of the financing subject to an early expiry provision. Upon closing, the brokered agent received a cash commission of \$245,782 and 13,896 units (for a total of 8% of the gross proceeds). The agent also received 529,417 common share purchase warrants exercisable for a period of one year at a price of \$0.60 per unit, an administrative fee of \$5,000, a corporate finance fee of 50,000 units, 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.

The fair value of the agent's warrants of \$37,063 was charged to share issue costs with an offsetting amount to contributed surplus. The fair value of the agent's warrants was determined using the Black Scholes model with the following assumptions; dividend yield of nil, expected volatility of 52%, risk-free rate of 4.32% and expected life of one year.

(e) Acquisition of Fort Garry Brewing Company Ltd.

Effective October 22, 2007 the Company acquired all the issued common shares of Fort Garry Brewing Company Ltd for cash consideration of \$309,247 and equity consideration of \$2,353,998 equivalent shares of the Company's common stock at a fair market value of \$0.56 per share. In addition the Company paid cash consideration of \$953,726 to redeem the 4% cumulative preferred shares of Fort Garry including their par value and accrued redemption premium and accrued dividends. The transaction costs are \$468,811, which include 100,000 common shares of the Company allotted at a fair market value of \$0.46 as part of a corporate finance fee. Refer to Note 3.

f) Share Purchase Warrants

At December 31, 2007, the following share purchase warrants were outstanding entitling the holders the right to purchase one common share for each warrant held:

Warrants	Weighted Average Exercise Price	Expiry Date
4,167,665	\$ 0.50	October 17, 2008
55,750	\$ 0.30	October 17, 2008
5,358,062	\$ 0.75	July 27, 2008
529,417	\$ 0.60	July 27, 2008
250,000 <sup>(1)</sup>	\$ 0.65	December 31, 2009
<u>10,360,894</u>	<u>\$ 0.64</u>	

(1) The fair value of 250,000 loan warrants granted pursuant to the loan agreement (Refer to Note 4) is \$30,000. This has been determined using the Black-Scholes Option Pricing Model with the following assumptions: - risk free interest rate of 4.30%; - expected life of 24 months and - expected volatility of 74%.

**RUSSELL BREWERIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**DECEMBER 31, 2007**

**NOTE 6 – 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 August 2007, the Company granted incentive stock options in the aggregate of 690,000 common shares to certain directors, officers and consultants, each at a price of \$0.55 per common share for a period of five years pursuant to the Company's Stock Option Plan.

A summary of the status of the Company's stock option plan as of December 31, 2007 and December 31, 2006 and changes during the periods then ended is presented below:

	December 31, 2007		December 31, 2006	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning balance	1,475,000	\$ 0.41	750,000	\$ 0.33
Granted	690,000	0.55	760,000	\$ 0.48
Exercised	-	-	-	-
Forfeited/Cancelled	-	-	(10,000)	\$ 0.33
Outstanding, ending balance	2,165,000	\$ 0.45	750,000	\$ 0.41

At December 31, 2007, the following stock options are outstanding:

Exercise Price	Outstanding		Exercisable	
	Number	Weighted Average Remaining Life (in years)	Number	Weighted Average Remaining Life (in years)
\$0.33	725,000	3.54	725,000	3.54
\$0.48	750,000	4.06	750,000	4.06
\$0.55	690,000	4.92	450,000	4.92

The fair values of the options granted during the period ended December 31, 2007 and 2006 were estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	December 31, 2007	December 31, 2006
Risk-free interest rate	4.31%	4.31%
Dividend yield	0%	0%
Expected stock price volatility	196%	120%
Expected life of options	5 years	5 years
Weighted average fair value per share	\$0.52	\$0.33

For the period ended December 31, 2007, the Company recognized stock based compensation in the amount of \$280,800 representing 540,000 stock options granted and vested, which is included in selling, general and administrative expenses.

**RUSSELL BREWERIES INC.**  
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**NOTE 7 - DUE FROM/TO RELATED PARTIES**

- a) At December 31, 2007, \$260 is due to (2007: \$nil) directors and relatives of directors. The amounts owing are unsecured, non interest bearing and have no specific terms for repayment.
- b) During the period ended December 31, 2007 and 2006, the Company incurred the following charges with directors of the Company and relatives of directors which are included in selling, general and administrative expenses:

	December 31, 2007	December 31, 2006
Compensation paid to relatives of directors	\$ 82,587	\$ 56,190
Consulting fees and salaries paid to directors	24,000	28,000
Management fees paid to directors	61,550	48,000
	<u>\$ 168,137</u>	<u>\$ 132,190</u>

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

During the period ended December 31, 2007, directors of the Company purchased nil (2007: 250,000) common shares through private placements.

**NOTE 8 – PRIOR PERIOD RESTATEMENT**

The prior period adjustment of \$25,557 is to correct errors of recording sales and accounts receivable for the period ended September 30, 2006. The errors caused overstatements of sales of \$25,557 resulting in understatements of net loss of \$25,557 and deficit of \$25,557 for the period ended September 30, 2006, as well as overstatements of accounts receivable of \$25,557 as of September 30, 2006. The result was to increase the reported net loss per share from \$0.013 to \$0.016 for the period ended September 30, 2006. The deficit and accounts receivable as of September 30, 2006 and sales for the period ended September 30, 2006 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 9 – COMPARATIVE FIGURES**

Certain 2007 figures have been reclassified to conform with the financial statement presentation adopted for the current year.

**NOTE 10 – SUBSEQUENT EVENTS**

The Company issued 100,000 common shares allotted as at December 31, 2007 in respect of part of a corporate finance fee relating to the Fort Garry acquisition.