
RUSSELL BREWERIES INC.
INTERIM CONSOLIDATED FINANCIAL
STATEMENTS
FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2008 AND 2007

UNAUDITED

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

	September 30, 2008	June 30, 2008 (Note 4)
ASSETS		
CURRENT		
Cash and cash equivalents	\$ 729,676	\$ 990,517
Accounts receivable	891,914	760,317
Inventories (Note 6)	933,475	841,113
Prepaid expenses and deposits	251,025	271,608
	2,806,090	2,863,555
PROPERTY AND EQUIPMENT (Note 7)	3,290,829	3,507,860
INTANGIBLE ASSETS (Note 8)	1,929,843	1,929,843
OTHER ASSETS (Note 9)	200,000	200,000
DEFERRED COSTS	-	-
	\$ 8,226,762	\$ 8,501,258
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	\$ 1,076,230	\$ 1,017,228
Demand bank loan (Note 10)	-	-
Current portion of long-term debt (Note 11)	256,254	256,254
Current portion of capital lease obligations (Note 12)	144,869	143,814
	1,477,353	1,417,296
LONG-TERM DEBT (Note 11)	1,592,192	1,611,890
CAPITAL LEASE OBLIGATIONS (Note 12)	253,135	266,271
	3,322,680	3,295,457
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 13)	7,847,022	7,847,022
EXCHANGEABLE PREFERRED SHARES (Note 14)	518,979	518,979
CONTRIBUTED SURPLUS (Note 15)	2,661,174	2,661,174
DEFICIT	(6,123,093)	(5,821,374)
	4,904,082	5,205,801
	\$ 8,226,762	\$ 8,501,258

COMMITMENTS AND CONTINGENCIES (Note 22)

Approved on behalf of the Board of Directors:

/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 OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT
(UNAUDITED)**

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007 (Note 4)
REVENUES	\$ 2,208,955	\$ 634,212
LESS: EXCISE TAX AND B.C. PROVINCIAL MARK-UP	510,027	181,747
NET REVENUES	1,698,928	452,465
COST OF SALES	762,963	99,329
GROSS MARGIN	935,965	353,136
EXPENSES		
Amortization	273,836	86,926
Selling, general and administrative (Notes 16 and 20)	903,290	942,335
	1,177,126	1,029,261
LOSS BEFORE OTHER INCOME (EXPENSE)	(241,161)	(676,125)
OTHER INCOME (EXPENSE):		
Interest on long-term debt	(61,812)	(17,861)
Interest income	1,254	22,918
	(60,558)	5,057
NET LOSS AND COMPREHENSIVE LOSS FOR THE PERIOD	(301,719)	(671,068)
DEFICIT, BEGINNING OF PERIOD, AS PREVIOUSLY REPORTED	(5,821,374)	(2,457,760)
RESTATEMENT (Note 4)	-	(332,276)
DEFICIT, AS RESTATED	(5,821,374)	(2,790,036)
DEFICIT, END OF PERIOD	\$ (6,123,093)	\$ (3,461,104)
LOSS PER SHARE (Note 18)		
Basic and diluted	\$ (0.01)	\$ (0.03)

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 September 30, 2008	Three Months Ended September 30, 2007 (Note 4)
CASH FLOWS PROVIDED BY (USED FOR):		
OPERATING ACTIVITIES		
Net loss for the year	\$ (301,719)	\$ (671,068)
Adjusted for non-cash items:		
Amortization	273,836	86,926
Accretion of long-term debt	30,303	-
Stock-based compensation expense	-	280,800
	2,420	(303,342)
Net changes in non-cash working capital items:		
Accounts receivable	(131,597)	102,426
Prepaid expenses and deposits	20,583	129,080
Inventories	(92,362)	(36,263)
Accounts payable and accrued liabilities	59,002	12,459
Due to and from related parties	-	(1,685)
	(141,954)	(97,325)
INVESTING ACTIVITIES		
Short-term investments	-	50,708
Deferred costs	-	(149,569)
Purchases of property and equipment	(33,872)	(373,401)
	(33,872)	(472,262)
FINANCING ACTIVITIES		
Proceeds from issuance of common shares and warrants, net of cash share issuance costs	-	2,858,011
Repayment of long-term debt	(50,001)	(12,501)
Repayment of capital lease obligations	(35,014)	(27,817)
Repayment of bank demand loan	-	(9,375)
	(85,015)	2,808,318
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(260,841)	2,238,731
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	990,517	(236,213)
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 729,676	\$ 2,002,518
CASH AND CASH EQUIVALENTS CONSIST OF:		
Demand deposits	\$ 378,537	\$ 19,865
Line of credit	(97,547)	(24,518)
Banker's acceptance and term deposits	448,686	2,007,171
	\$ 729,676	\$ 2,002,518

SUPPLEMENTAL CASH FLOW INFORMATION (Note 19)

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

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

1. NATURE OF OPERATIONS

Russell Breweries Inc. (the "Company") was incorporated under the laws of the Province of British Columbia, Canada on March 23, 2000. The Company produces beer primarily for sale to provincial liquor distribution organizations and entities engaged in the food and beverage industries within Canada. The Company's shares are traded on the TSX Venture Exchange (the "TSX-V").

2. SIGNIFICANT ACCOUNTING POLICIES**(a) Basis of Presentation**

These interim consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles, are presented in Canadian dollars and include the accounts of the Company and its wholly-owned subsidiary Russell Brewing Company Ltd. ("Russell"), and its wholly-owned subsidiary Fort Garry Brewing Company Ltd. ("Fort Garry") for the three months ended September 30, 2008 (see Note 5). All significant inter-company balances and transactions have been eliminated upon consolidation.

Certain comparative figures have been reclassified to conform to the presentation adopted for the current year.

(b) Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the notes thereto. Significant areas requiring the use of estimates include the recoverability or valuation of accounts receivable, the estimated life of and return rates for returnable containers in inventory, the useful lives of property and equipment, assumptions embodied in the valuation and impairment tests for intangible assets, income tax rates, the recoverability of future income tax assets, stock-based compensation, and the disclosure of contingent liabilities at the date of the financial statements. Actual results may differ from those estimates.

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

Cash and cash equivalents, when applicable, include cash on account, demand deposits and money market investments with maturities from the date of acquisition of 90 days or less, which are readily convertible to known amounts of cash and are subject to insignificant changes in value.

(ii) Short-Term Investments

The Company considers all highly liquid financial instruments purchased with a maturity greater than 90 days but less than one year at the date of purchase to be short-term investments. Short-term investments are classified as available-for-sale and are recorded at their fair values using quoted market prices at the balance sheet date. Unrealized gains or losses on available-for-sale investments are recognized in other comprehensive income. Investment transactions are recognized on the trade date with transaction costs included in the underlying balance.

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

2. SIGNIFICANT ACCOUNTING POLICIES (continued)**(c) Financial Instruments (continued)****(iii) Trade Receivables and Payables**

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

(iv) Bank Indebtedness

The Company has a bank operating line of credit with a limit of \$100,000, which bears interest at prime, matures on August 31, 2010 and is secured by a term deposit of \$100,000 (see Note 9).

(v) Long-Term Debt

Long-term debt is initially recorded at total proceeds received less direct issuance costs. Long-term debt is subsequently measured at amortized cost and calculated using the effective interest rate method.

(d) Inventories

Raw materials, supplies, finished goods and work-in-progress are valued at the lower of cost, determined using the first-in, first-out method, and net realizable value. The cost of finished goods and work-in-progress includes direct materials, labour and overhead costs. Returnable containers are recorded at cost and are amortized over their estimated useful lives of seven years.

(e) Property and Equipment**(i) Amortization Methods and Rates**

Property and equipment is recorded at cost less accumulated amortization. Amortization is recognized on the declining balance basis at the following rates per annum:

Computers	30%
Equipment	30%
Office furniture and equipment	20%
Vehicles	30%
Website	30%

Leasehold improvements are amortized on a straight-line basis over the term of the related lease.

(ii) Asset Impairment

The Company performs impairment tests on its property and equipment when events or changes in circumstances occur that indicate the carrying value of an asset may not be recoverable. Estimated future cash flows are calculated using estimated future prices and operating and capital costs on an undiscounted basis. When the carrying value of the property and equipment exceeds estimated future cash flows, the asset is impaired. Write-downs are recorded to the extent the carrying value exceeds the discounted value of the estimated future cash flows based on the Company's average cost of borrowing.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Property and Equipment (continued)

(iii) Repairs and Maintenance

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

(f) Intangible Assets and Impairment Tests

Intangible assets are assets acquired that lack physical substance and that meet the specified criteria for recognition apart from goodwill. The Company's intangible assets consist of brands and trademarks. Brands and trademarks have an indefinite life and are not amortized. Indefinite life intangible assets are tested for impairment annually or when indicated by events or changes in circumstances, by comparing the fair value of the assets to their carrying value. During the year the Company performed an impairment test for intangible assets and determined no write-down was necessary.

(g) Revenue Recognition

Revenue is recognized when the significant risks and rewards of ownership are transferred to the provincial liquor boards or retail customers and collection of the relevant receivable is probable, which is generally upon delivery of the Company's products. Anticipated product returns are provided for at the time of sale. Net revenue represents gross revenues less applicable excise taxes and fees levied by provincial liquor boards.

(h) Stock-Based Compensation

The Company has a plan for granting stock options to management, directors, employees and consultants of the Company. The Company recognizes compensation expense for this plan under the fair value based method in accordance with CICA Handbook section 3870 "Stock-Based Compensation and Other Stock-Based Payments". Under this method, the fair value of each option grant, estimated using the Black-Scholes option-pricing model, is recognized as stock-based compensation expense over the vesting period and credited to contributed surplus. Consideration paid on the exercise of stock options and the related carrying value in contributed surplus is recorded as share capital at the time of exercise.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) 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.

(j) Earnings/Loss per Share

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

3. ADOPTION OF NEW ACCOUNTING STANDARDS AND DEVELOPMENTS

(a) Accounting Changes

Effective July 1, 2007, the Company adopted the revised CICA 1506, "Accounting Changes", which requires that: (i) a voluntary change in accounting principles can be made if, and only if, the changes result in more reliable and relevant information, (ii) changes in accounting policies are accompanied with disclosures of prior period amounts and justification for the change, and (iii) for changes in estimates, the nature and amount of the change should be disclosed. The Company has not made any voluntary change in accounting principles since the adoption of the revised standard.

(b) Financial Instruments

Effective July 1, 2007, the Company adopted the three new accounting standards and related amendments to other standards on financial instruments issued by the CICA. Prior periods have not been restated.

(i) CICA 3855, "Financial Instruments – Recognition and Measurement"

This standard prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and whether fair value or cost-based methods are used to measure the recorded amounts. It also specifies how financial instrument gains and losses are to be presented. Effective July 1, 2007, the Company's cash equivalents have been classified as held-for-trading and are recorded at fair value on the balance sheet. Fair values are determined directly by reference to published price quotations in an active market. Changes in the fair value of these instruments are reflected in foreign exchange gain/loss in the statement of operations. All other financial instruments will be recorded at cost or amortized cost, subject to impairment reviews. The criteria for assessing an other than temporary impairment remain unchanged. Transaction costs incurred to acquire financial instruments are included in the underlying balance. Regular-way purchases and sales of financial assets are accounted for on the trade date.

3. ADOPTION OF NEW ACCOUNTING STANDARDS AND DEVELOPMENTS (continued)

(b) Financial Instruments (continued)

(ii) CICA 3865, "Hedges"

This standard is applicable when a company chooses to designate a hedging relationship for accounting purposes. It builds on the previous AcG-13, "Hedging Relationships", and CICA 1650, "Foreign Currency Translation", by specifying how hedge accounting is applied and what disclosures are necessary when it is applied. The Company had no hedging relationships as at July 1, 2007. There was no impact on the Company's financial statements upon adoption of this standard.

(iii) CICA 1530, "Comprehensive Income"

This standard requires the presentation of a statement of comprehensive income and its components. Comprehensive income includes both net earnings and other comprehensive income. Other comprehensive income includes holding gains and losses on available for sale investments, gains and losses on certain derivative instruments and foreign currency gains and losses relating to self-sustaining foreign operations, all of which are not included in the calculation of net earnings until realized. During the three months ended September 30, 2008, there were no items classified as other comprehensive income.

(c) CICA 3064, "Goodwill and Intangible Assets"

In February 2008, the CICA issued Handbook Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Intangible Assets", and Section 3450, "Research and Development Costs". Section 3064 establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This new standard applies to interim and annual financial statements for fiscal years beginning on or after October 1, 2008. Early adoption is permitted. The Company expects to adopt the standard commencing for its interim and annual financial statements for the fiscal year ending June 30, 2009. The Company is currently assessing the impact of the adoption of this standard and has not yet determined its effect on its financial statements.

(d) International Financial Reporting Standards

In February 2008, the CICA Accounting Standards Board confirmed that public companies will be required to prepare interim and annual financial statements under International Financial Reporting Standards ("IFRS") for fiscal years beginning on or after January 1, 2011. The Company is currently assessing the impact of adopting IFRS and has not yet determined its effect on its financial statements.

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

4. RESTATEMENT OF PRIOR PERIOD FIGURES

- (a) During the year ended June 30, 2008, the Company determined that it had inappropriately accounted for amortization expense relating to its property and equipment during the years ended June 30, 2007, 2006 and 2005. The comparative financial statements for the year ended June 30, 2007 have been restated to reflect a \$92,440 decrease in property and equipment, a \$20,697 increase in amortization expense and a \$71,743 increase in deficit.
- (b) During the year ended June 30, 2008, the Company determined that it had inappropriately recognized \$108,164 of compensation cost as stock-based compensation expense during the year ended June 30, 2007 relating to stock options granted during that year. The Company previously recognized the full amount of compensation cost relating to these stock options on their grant date. However, as these stock options had a vesting period of one year, the Company determined it was more appropriate to recognize the compensation costs over the vesting period using the straight-line attribution method. The comparative financial statements for the year ended June 30, 2007 have been restated to reflect \$108,164 reductions in contributed surplus and stock-based compensation expense, which is included in selling, general and administrative expense in the statement of operations.
- (c) During the year ended June 30, 2008, the Company determined that it had inappropriately de-recognized \$348,000 of compensation cost during the year ended June 30, 2006 relating to stock options granted and cancelled during that year. As these stock options vested on their grant date, the Company determined it was more appropriate to recognize the related compensation cost as stock-based compensation expense during the year they were granted. The comparative financial statements for the year ended June 30, 2007 have been restated to reflect \$348,000 increases in contributed surplus and deficit.

The following table summarizes the restatement of the affected balances:

June 30, 2007	As		As Restated
	Previously Reported	Change	
Statement of Operations:			
Amortization	183,417	\$ 20,697	\$ 204,114
Selling, general and administrative	1,950,240	(108,164)	1,842,076
Net loss	1,201,377	(87,467)	1,113,910
Loss per share – basic and diluted	0.09	(0.01)	0.08
Deficit, beginning of year	1,256,383	419,743	1,676,126
Deficit, end of year	2,457,760	332,276	2,790,036
Balance Sheet:			
Property and equipment	903,903	(92,440)	811,463
Contributed surplus	1,075,473	239,836	1,315,309
Deficit	2,457,760	\$ 332,276	\$ 2,790,036

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

5. ACQUISITION OF FORT GARRY BREWING COMPANY LTD.

Effective October 22, 2007, the Company acquired all the common shares of Fort Garry in exchange for 4,203,566 common shares of the Company and cash consideration of \$309,247. In addition, the Company paid cash consideration of \$953,726 to redeem the 4% cumulative preferred shares of Fort Garry including their par value, accrued redemption premium and accrued dividends. In connection with the transaction, the Company incurred direct and incremental costs of \$431,011, including the issuance of 100,000 common shares of the Company valued at \$56,000, which represents the fair value of the shares on the measurement date. The acquisition of Fort Garry has been accounted for using the purchase method, with the Company as the acquirer. The cost of the purchase has been allocated to the assets and liabilities acquired based on their fair values as determined by an independent valuation. Fort Garry's results of operations are included in the interim consolidated financial statements from July 1, 2008. The comparative figures for the interim consolidated balance sheet presented as at June 30, 2008 include the results of operations of Fort Garry from October 23, 2007. The comparative figures for the statements of loss and deficit and cash flows for the three months ended September 30, 2007 do not include the results of operations of Fort Garry.

A summary of the consideration paid is as follows:

	Amount
Common shares of the Company issued to shareholders of Fort Garry	\$ 2,518,318
Cash paid to shareholders of Fort Garry	309,247
Cash paid for preferred shares of Fort Garry	953,726
Transaction costs	431,011
Purchase price	<u>\$ 4,212,302</u>

The Company's allocation of the purchase price to the estimated fair values of the assets and liabilities of Fort Garry is as follows:

	Amount
Cash and cash equivalents	\$ 202,435
Accounts receivable	279,769
Inventories	349,125
Prepaid expenses and deposits	52,546
Property and equipment	2,862,781
Intangible assets	1,928,043
Future income tax assets	507,698
Total assets acquired	6,182,397
Accounts payable and accrued liabilities	(508,035)
Long-term debt	(918,750)
Capital leases obligations	(35,612)
Future income tax liabilities	(507,698)
Net assets acquired	<u>\$ 4,212,302</u>

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

6. INVENTORIES

	September 30, 2008		June 30, 2008	
Finished goods and work-in-progress	\$	254,808	\$	190,421
Raw materials		344,800		295,825
Supplies		54,899		61,087
Returnable containers, net of amortization		278,967		293,780
	\$	933,475	\$	841,113

7. PROPERTY AND EQUIPMENT

	September 30, 2008		June 30, 2008	
	Cost	Accumulated Depreciation	Net Book Value	Net Book Value
Computers	\$ 56,265	\$ 34,018	\$ 22,247	\$ 22,547
Equipment	5,587,068	2,874,959	2,712,109	2,890,796
Leasehold improvements	1,246,807	920,157	326,650	346,729
Office furniture and fixtures	50,651	36,478	14,173	14,653
Vehicles	509,096	295,021	214,075	231,431
Website	4,825	3,249	1,576	1,704
	\$7,454,712	\$ 4,163,882	\$3,290,830	\$3,507,860

Capital assets acquired under capital leases are included in equipment with a cost of \$280,654 (June 30, 2008 – \$257,721) less accumulated depreciation of \$108,476 (June 30, 2008 – \$94,516) and vehicles with a cost of \$494,694 (June 30, 2008 – \$494,694) less accumulated depreciation of \$290,830 (June 30, 2008 – \$274,300).

8. INTANGIBLE ASSETS

	September 30, 2008		June 30, 2008	
Brands and trademarks (Note 5)	\$	1,929,843	\$	1,929,843

9. OTHER ASSETS

	September 30, 2008		June 30, 2008	
Term deposits	\$	200,000	\$	200,000

A term deposit of \$100,000 has been pledged as security for a \$100,000 bank line of credit (June 30, 2008 – \$100,000) and another term deposit of \$100,000 has been pledged as security for capital leases (June 30, 2008 – \$100,000).

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

10. DEMAND BANK LOAN

During the year ended June 30, 2008, the Company repaid a demand bank loan. The loan bore interest at the bank's prime rate plus 3% per annum and was secured by 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.

11. LONG-TERM DEBT

	September 30, 2008	June 30, 2008
Term loan, bearing variable interest at prime plus 2.5%, repayable in monthly installments of \$4,167 plus interest maturing on October 31, 2009, secured by the assets of Russell and a personal guarantee of \$62,500 by a director of the Company	\$ 55,193	\$ 67,694
Term loan, bearing interest at 8.8%, repayable in monthly installments of \$18,750 plus interest maturing July 15, 2009, secured by the assets of Fort Garry	825,000	862,500
Discount loan, bearing interest at 8.5% per annum compounded semi-annually, \$1,239,000 due December 31, 2010, secured by the assets of Russell and Fort Garry	968,253	937,950
	1,848,446	1,868,144
Less: current portion of long-term debt	(256,254)	(256,254)
	\$ 1,592,192	\$1,611,890

On December 31, 2007, the Company entered into a loan agreement pursuant to which the lender, a shareholder of the Company, provided to the Company a discounted loan valued at \$1,239,000 at maturity. Under the agreement, a notional principal amount of \$965,000 was assigned to the loan. In connection with the loan, the lender was entitled to a \$25,000 bonus which was deducted from the notional principal amount of \$965,000, resulting in net proceeds to the Company of \$940,000. The Company also issued 250,000 warrants to the lender, each warrant entitling the lender to purchase one common share of the Company at a price of \$0.65 per share for a period of two years expiring on December 31, 2009. Net proceeds of \$896,040 and \$43,960 were allocated to the loan and warrants, respectively, based on their relative fair values on December 31, 2007. The Company incurred cash debt issue costs of \$14,435 which were recorded as a discount against the value allocated to the loan. During the three months September 30, 2008, the Company recorded interest expense of \$30,303 related to the accretion of the discounted value of the loan, which has been recorded as interest on long-term debt in the statement of operations.

The fair values of the warrants issued in connection with the loan were computed using the Black-Scholes option-pricing model. The Company may repay the loan at any time without penalty by paying the notional principal amount of \$965,000 plus accumulated interest. As at September 30, 2008, the fair value of this early settlement option was estimated to be \$nil.

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

11. LONG-TERM DEBT (continued)

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

Fiscal Year	Amount
2009	\$ 206,523
2010	673,940
2011	965,000
	<u>\$ 1,845,463</u>

12. CAPITAL LEASE OBLIGATIONS

The Company finances certain property and equipment using capital leases which bear interest at rates ranging from 1% to 28% and expire on various dates through April 2013. Estimated future minimum lease payments under these capital leases are as follows:

	Amount
Fiscal Year:	
2009	\$ 147,963
2010	176,338
2011	104,243
2012	37,499
2013	7,059
Total minimum lease payments	473,102
Less: amount representing interest	(75,098)
Present value of minimum lease payments	398,004
Less: current portion of capital lease obligations	(144,869)
	<u>\$ 253,135</u>

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

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

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

(b) Issued and Outstanding Share Capital

	Common Shares	Amount
Balance, June 30, 2006	10,022,135	\$ 1,371,365
Issued during the year:		
For cash:		
Private placement, net of share issue costs (ii)	5,000,000	841,500
Exercise of warrants	1,216,085	551,293
For corporate finance services (ii)	100,000	30,000
Balance, June 30, 2007	16,338,220	2,794,158
Issued during the year:		
For cash:		
Private placement, net of share issue costs (i)	5,294,166	1,923,697
Exercise of warrants	660,500	198,150
For acquisition of Fort Garry (Note 5)	4,203,568	2,518,318
For services:		
Shares issued for corporate finance services (i)	63,896	38,338
Shares issued for consulting services (Note 5)	100,000	56,000
Transferred from contributed surplus upon exercise of warrants	–	318,361
Balance, June 30, 2008 and September 30, 2008	26,660,350	\$ 7,847,022

- (i) On July 27, 2007, the Company closed a brokered private placement of 5,294,166 units at a price of \$0.60 per unit for gross proceeds of \$3,176,500. 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 \$0.75 for a period of one year expiring July 27, 2008, subject to an early expiry provision. Values of \$2,423,077 and \$753,423 were assigned to the common shares and warrants, respectively, based on their relative fair values at the closing date of the private placement. In connection with the private placement, the Company issued 63,896 units as a commission and corporate finance fee with terms similar to those issued under the private placement. Values of \$38,338 and \$11,921 were assigned to the common shares and warrants, respectively, based on their fair values at the closing date of the private placement. The Company also issued as a commission 529,417 common share purchase warrants exercisable for a period of one year at a price of \$0.60 per share. These warrants were assigned a value of \$98,779, based on their fair value at the closing date of the private placement. The Company paid cash commissions of \$245,782 and incurred other cash share issuance costs of \$104,560. The fair values of the warrants issued in connection with this private placement were computed using the Black-Scholes option-pricing model.

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

13. SHARE CAPITAL (continued)**(b) Issued and Outstanding Share Capital (continued)**

- (ii) 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 consisted 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 units, and was reimbursed for reasonable expenses related to the private placement. The fair value of the agent's warrants of \$482,000 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 option-pricing model.

(c) Stock Options

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

Stock option activity since June 30, 2007 is presented below:

	September 30, 2008		June 30, 2008	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning	2,605,000	\$ 0.41	1,475,000	\$ 0.41
Granted	-	-	1,690,000	0.46
Exercised	-	-	-	-
Forfeited	-	-	(560,000)	0.55
Outstanding, ending	2,605,000	\$ 0.41	2,605,000	\$ 0.41

At September 30, 2008, the following stock options are outstanding:

Options Outstanding			Options Exercisable		
Exercise Price	Number of Shares	Weighted Average Remaining Life (in years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
\$	Shares	(in years)	\$	Shares	\$
0.33	715,000	2.52	0.33	715,000	0.33
0.40	1,000,000	4.72	0.40	1,000,000	0.40
0.48	750,000	3.06	0.48	750,000	0.48
0.55	140,000	3.92	0.55	140,000	0.55
	2,605,000	3.60	0.41	2,605,000	0.41

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

13. SHARE CAPITAL (continued)**(d) Warrants**

Warrant activity since June 30, 2007 is presented below:

	September 30, 2008		June 30, 2008	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	10,360,894	\$ 0.64	4,883,915	\$ 0.47
Granted	-	-	6,137,479	0.75
Exercised	-	-	(660,500)	0.30
Expired	(10,110,894)	\$ 0.64	-	-
Outstanding, ending of year	250,000	\$ 0.64	10,360,894	\$ 0.64

At September 30, 2008, the following warrants were outstanding entitling the holders the right to purchase one common share for each warrant held:

Number of Warrants	Weighted Average Exercise Price	Expiry Date
250,000	0.65	December 31, 2009
250,000	\$ 0.65	

Between June 30, 2008 and October 24, 2008, 10,110,894 warrants exercisable at prices from \$0.30 to \$0.75 expired unexercised.

(e) Agent Warrants

At September 30, 2008, the following agent warrants were outstanding entitling the holders the right to purchase 16.67 common shares at a price of \$10.00 for each warrant held (see Note 14):

Number of Warrants	Number of Shares	Weighted Average Exercise Price per Warrant	Weighted Average Exercise Price per Share	Expiry Date
6,800	113,333	\$ 10.00	\$ 0.60	March 31, 2010

(e) Escrow Shares

During the year ended June 30, 2008, the 441,000 common shares of the Company held in escrow at June 30, 2007 were released.

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

14. EXCHANGEABLE PREFERRED SHARES

On March 31, 2008, the Company's wholly-owned subsidiary, Russell Brewing Company Ltd. ("Russell"), completed a brokered private placement for 68,000 exchangeable, non-voting preferred shares (the "Exchangeable Shares") at a price of \$10 per share for gross proceeds of \$680,000 under the Equity Capital Program of the Province of British Columbia (the "Program"). In connection with the private placement, the Company issued 6,800 agent warrants allowing the holder to purchase 16.67 common shares of the Company per warrant at a price of \$0.60 per common share until March 31, 2010. These agent warrants were assigned a fair value of \$21,396 which was determined using the Black-Scholes option-pricing model. The Company also paid a commission of \$54,400 and incurred other cash issuance costs of \$60,000.

The Exchangeable Shares have a 6% per annum cumulative dividend, payable semi-annually, in accordance with rules under the Program. After five years (the "Exchange Date"), each Exchangeable Share will automatically be exchanged into 16.67 common shares of the Company, or earlier if certain events occur, including a change in control of the Company or an insolvency event in Russell. At the Exchange Date, the exchange ratio will be increased for any penalty incurred or for any unpaid dividends.

Russell will incur a penalty if it has not paid all cumulative dividends due and payable as of March 31, 2011 and for any unpaid dividends calculated each six months thereafter until the Exchange Date. The maximum penalty would result in one additional common share of the Company being exchanged for each Exchangeable Share. The exchange ratio will also increase to account for any unpaid dividends at the Exchange Date such that the additional number of the Company's common shares to be issued is equal to the unpaid dividend amount divided by \$0.60.

15. CONTRIBUTED SURPLUS

	September 30, 2008	June 30, 2008
Balance, beginning of year	\$ 2,661,174	\$ 1,315,309
Stock-based compensation expense (Note 16)	-	734,748
Relative fair value of warrants issued in private placements	-	753,423
Fair value of warrants issued for share issue costs	-	110,699
Fair value of agent warrants issued for share issue costs	-	21,396
Fair value of warrants issued with long-term debt	-	43,960
Amount transferred to share capital upon exercise of warrants	-	(318,361)
Balance, end of year	\$ 2,661,174	\$ 2,661,174

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

16. STOCK-BASED COMPENSATION

During the three months ended September 30, 2008, the Company granted nil (June 30, 2008 – 1,690,000) stock options to directors, officers and consultants of the Company. The weighted average fair value of each option granted was calculated using the Black-Scholes option-pricing model at the date of each grant using the following weighted average assumptions:

	June 30, 2008
Expected option lives	5 years
Risk-free interest rate	3.9%
Expected dividend yield	0%
Expected stock price volatility	128%

During the three months ended September 30, 2008, the Company recognized \$nil (2007 – \$280,800) of compensation cost which is included in selling, general and administrative expenses.

17. INCOME TAXES

In assessing the realization of the Company's future income tax assets, management considers whether it is more likely than not that some portion of all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of 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 future tax assets considered realizable could change materially in the near term based on future taxable income during the carry-forward period.

As at September 30, 2008, the Company has non-capital losses of approximately \$6,724,000 which may be carried forward to apply against future years income tax for Canadian income tax purposes, subject to final determination by taxation authorities and expiring as follows in the fiscal years ending:

Year of Expiry	Amount
2009	\$ 1,219,000
2010	801,000
2014	199,000
2015	555,000
2026	243,000
2027	2,099,000
2028	1,608,000
	<u>\$ 6,724,000</u>

18. LOSS PER SHARE

The weighted average number of shares outstanding used in the computation of loss per share was 26,660,350 (2007 – 20,240,287). Outstanding stock options, warrants and agent warrants have not been considered in the computation of diluted loss per share as the result is anti-dilutive.

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

19. SUPPLEMENTAL CASH FLOW INFORMATION

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007
Cash paid for:		
Interest	\$ 31,509	\$ 17,861
Income taxes	-	-
Non-cash investing and financing activities:		
Capital lease obligations recognized for assets under capital lease	22,933	75,371
Common shares issued for services	-	75,401

20. RELATED PARTY TRANSACTIONS

During the three months ended September 30, 2008, the Company incurred salaries and wages expense of \$14,252 to relatives of directors of the Company (2007 – \$28,683). The transactions were in the normal course of operations and have been recorded at their exchange amounts, which is the consideration agreed upon by the related parties.

21. FINANCIAL INSTRUMENTS AND RISKS**(a) Fair Values of Financial Instruments**

The carrying values of current financial assets and liabilities are reasonable estimates of fair values due to the relatively short periods to maturity and the commercial terms of these instruments. The carrying amount of long-term financial liabilities at June 30, 2008 is considered to be a reasonable estimate of fair value based on current market rates for similar financial instruments.

(b) Credit Risk

Credit risk arises from the non-performance by counterparties of contractual financial obligations. The Company maintains substantially all of its cash and cash equivalents and term deposits classified as other assets in the balance sheet with major financial institutions. Deposits held with these institutions may exceed the amount of insurance provided on such deposits. The Company manages credit risk for trade and other receivables through established credit monitoring activities.

(c) Liquidity Risk

The Company manages liquidity risk by maintaining adequate cash and cash equivalent balances. The Company continuously monitors and reviews both actual and forecasted cash flows, and also matches the maturity profile of financial assets and liabilities.

(d) Interest Rate Price Risk

The Company's cash equivalents are subject to interest rate price risk. The Company's interest rate risk management policy is to purchase highly liquid investments with a term to maturity of three months or less on the date of purchase, when the instrument is not required as security for another financial obligation. Certain of the Company's long-term debt instruments and capital lease obligations are subject to interest rate price risk as they carry fixed rates of interest.

(e) Interest Rate Cash Flow Risk

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

RUSSELL BREWERIES INC.**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

22. COMMITMENTS AND CONTINGENCIES

- (a) The Company's future minimum operating lease payments for premises and vehicles are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2009	\$ 328,744
2010	99,837
2011	102,747
2012	102,251
2013	81,765
2014	13,628
	<u>\$ 728,972</u>

- (b) As at September 30, 2008, the Company had issued a general excise bond of \$55,000 in favour of the Minister of National Revenue of Canada.