
RUSSELL BREWERIES INC.
CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED
DECEMBER 31, 2009 AND 2008

UNAUDITED

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

	December 31, 2009	June 30, 2009
ASSETS		
CURRENT		
Cash and cash equivalents	\$ -	\$ 488,616
Accounts receivable	548,995	1,205,988
Inventories (Note 5)	1,355,880	1,002,455
Prepaid expenses and deposits	266,162	267,395
Due from related parties (Note 18(b))	42,375	42,375
	2,213,412	3,006,829
PROPERTY AND EQUIPMENT (Note 6)	2,111,533	2,568,720
INTANGIBLE ASSETS (Note 7)	1,933,316	1,932,503
OTHER ASSETS (Note 8)	200,000	200,000
	\$ 6,458,261	\$ 7,708,052
LIABILITIES		
CURRENT		
Bank indebtedness	\$ 36,670	\$
Accounts payable and accrued liabilities	1,096,585	1,732,237
Dividend payable (Note 12)	61,200	40,800
Current portion of long-term debt (Note 9)	225,000	242,690
Current portion of capital lease obligations (Note 10)	140,117	158,848
	1,559,572	2,174,575
LONG-TERM DEBT (Note 9)	1,561,897	1,605,775
CAPITAL LEASE OBLIGATIONS (Note 10)	73,625	124,753
	3,195,094	3,905,103
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 11)	8,321,132	8,321,132
EXCHANGEABLE PREFERRED SHARES (Note 12)	518,979	518,979
CONTRIBUTED SURPLUS (Note 13)	3,002,301	3,002,301
DEFICIT	(8,579,245)	(8,039,463)
	3,263,167	3,802,949
	\$ 6,458,261	\$ 7,708,052
COMMITMENTS AND CONTINGENCIES (Note 20)		

Approved on behalf of the Board of Directors:

/s/ Andrew Harris
Andrew Harris, Director

/s/ Brian Harris
Brian Harris, Director

RUSSELL BREWERIES INC.**CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT****(UNAUDITED)**

	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008	Six Months Ended December 31, 2009	Six Months Ended December 31, 2008
REVENUES (Note 22)	\$ 1,857,770	\$ 1,746,981	\$ 4,219,810	\$ 3,955,936
LESS: EXCISE TAX AND PROVINCIAL MARK-UP	471,417	396,255	999,497	906,282
NET REVENUES	1,386,353	1,350,726	3,220,313	3,049,654
COST OF SALES	589,500	837,972	1,402,351	1,600,935
GROSS MARGIN	796,853	512,754	1,817,962	1,448,719
EXPENSES				
Amortization	254,423	277,954	507,749	551,790
Selling, general and administrative (Notes 14 and 18)	893,054	902,100	1,746,468	1,805,390
	1,147,477	1,180,054	2,254,217	2,357,180
LOSS BEFORE OTHER INCOME (EXPENSE)	(350,624)	(667,300)	(436,255)	(908,461)
OTHER INCOME (EXPENSE)				
Interest on long-term debt	(51,625)	(59,309)	(107,005)	(121,121)
Interest income	(1,575)	6,165	(1,351)	7,419
Other income	(8,259)	–	25,229	–
	(61,459)	(53,144)	(83,127)	(113,702)
NET LOSS AND COMPREHENSIVE LOSS FOR THE PERIOD	(412,083)	(720,444)	(519,382)	(1,022,163)
DEFICIT, BEGINNING OF THE PERIOD	(8,156,962)	(6,123,093)	(8,039,463)	(5,821,374)
DIVIDENDS (Note 12)	(10,200)	–	(20,400)	–
DEFICIT, END OF THE PERIOD	\$ (8,579,245)	\$ (6,843,537)	\$ (8,579,245)	\$ (6,843,537)
LOSS PER SHARE (Note 16)				
Basic and diluted	\$ (0.01)	\$ (0.03)	\$ (0.02)	\$ (0.04)

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

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

	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008	Six Months Ended December 31, 2009	Six Months Ended December 31, 2008
CASH FLOWS PROVIDED BY (USED FOR):				
OPERATING ACTIVITIES				
Net loss for the year	\$ (412,083)	\$ (720,444)	\$ (519,382)	\$ (1,022,163)
Adjusted for non-cash items:				
Amortization	254,423	277,954	507,749	551,790
Accretion of long-term debt	34,311	30,302	68,622	60,605
Stock-based compensation expense	—	—	—	—
	(123,349)	(412,188)	56,989	(409,768)
Net changes in non-cash working capital items:				
Accounts receivable	105,888	303,102	656,993	171,505
Prepaid expenses and deposits	28,611	8,830	1,233	29,413
Inventories	(217,678)	43,265	(379,126)	(49,097)
Accounts payable and accrued liabilities	88,779	157,410	(635,652)	216,412
	(117,749)	100,419	(299,563)	(41,535)
INVESTING ACTIVITIES				
Purchases of property and equipment	(22,449)	(60,833)	(24,861)	(94,705)
Acquisition of intangible assets	(813)	-	(813)	-
	(23,262)	(60,833)	(25,674)	(94,705)
FINANCING ACTIVITIES				
Repayment of long-term debt	(61,439)	(50,000)	(130,190)	(100,001)
Repayment of capital lease obligations	(35,375)	(41,712)	(69,859)	(76,726)
	(96,814)	(91,712)	(200,049)	(176,727)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(237,825)	(52,126)	(525,286)	(312,967)
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	201,155	729,676	488,616	990,517
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	\$ (36,670)	\$ 677,550	\$ (36,670)	\$ 677,550
CASH AND CASH EQUIVALENTS CONSIST OF:				
Demand deposits	\$ 54,013	\$ 496,343	\$ 54,013	\$ 496,343
Line of credit	(90,683)	(24,772)	(90,683)	(24,772)
Banker's acceptance and term deposits	—	205,979	—	205,979
	\$ (36,670)	\$ 677,550	\$ (36,670)	\$ 677,550

SUPPLEMENTAL CASH FLOW INFORMATION (Note 17)

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

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 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 Fort Garry Brewing Company Ltd. ("Fort Garry") for the periods ended December 31, 2009 and 2008. 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 period.

(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 CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

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. Trade receivables are designated as loans and receivables and trade payables are designated as other financial liabilities.

(iv) Long-Term Debt

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

(v) Derivative Instruments

Derivative instruments, including embedded derivatives, are recorded on the balance sheet at fair value. Unrealized gains and losses on derivatives held for trading are recorded in net earnings. Fair values for derivative instruments held for trading are determined using valuation techniques. These valuations use assumptions based on market conditions existing at the balance sheet date. Derivatives embedded in non-derivative contracts are recognized separately unless they are closely related to the host contract.

(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.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)**(e) Property and Equipment (continued)****(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.

(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 events or changes in circumstances indicate impairment, 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, persuasive evidence of an arrangement exists, the price is fixed or determinable 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 as described in Note 11(c). The Company recognizes compensation expense under this plan using the fair value method in accordance with CICA Handbook section 3870 "Stock-Based Compensation and Other Stock-Based Payments". Under this method, the fair value of stock options granted to employees is recognized as stock-based compensation expense over the vesting period and credited to contributed surplus. Stock options granted to non-employees are measured at their fair value on the vesting date. Prior to the vesting date, the then-current fair value of stock options granted to non-employees is recognized as stock-based compensation expense from the date of grant to the reporting date and credited to contributed surplus. Upon the exercise of stock options, consideration paid and the fair value amounts previously credited to contributed surplus are recorded as share capital. The Company uses the Black-Scholes option-pricing model to estimate the fair value of stock options granted.

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 substantively enacted tax rates which apply when these differences are expected to 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, agent warrants and agent unit options.

(k) Recent Accounting Pronouncements

Recent accounting pronouncements that have been announced but are not yet effective are as follows:

(i) CICA 1582, "Business Combinations", CICA 1601, "Consolidated Financial Statements" and CICA 1602, "Non-Controlling Interests"

In January 2009, the CICA issued Section 1582 "Business Combinations" to replace Section 1581. Prospective application of the standard is effective January 1, 2011, with early adoption permitted. This new standard effectively harmonizes the business combinations standard under Canadian GAAP with International Financial Reporting Standards ("IFRS"). The new standard revises guidance on the determination of the carrying amount of the assets acquired and liabilities assumed, goodwill and accounting for non-controlling interests at the time of a business combination. The CICA concurrently issued Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-Controlling Interests," which replace Section 1600 "Consolidated Financial Statements."

Section 1601 provides revised guidance on the preparation of consolidated financial statements and Section 1602 addresses accounting for non-controlling interests in consolidated financial statements subsequent to a business combination. These standards are effective January 1, 2011, unless they are early adopted at the same time as Section 1582 "Business Combinations." The Company is currently assessing the impact of adopting these standards and has not yet determined its effect on its financial statements.

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

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets," which replaces Section 3062, "Goodwill and Other Intangible Assets." This new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets and is effective for the Company beginning July 1, 2009. Concurrent with the adoption of this standard, EIC-27, "Revenues and Expenditures in the Pre-operating Period," will be withdrawn. The Company is currently assessing the impact of adopting this standard and has not yet determined its effect on its financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Recent Accounting Pronouncements (continued)

(iii) 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 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.

3. ADOPTION OF NEW ACCOUNTING STANDARDS

(a) CICA 3862, “Financial Instruments – Disclosures” and CICA 3863, “Financial Instruments Presentation”

These standards relate to the disclosures and presentation of financial instruments. They apply to interim and annual financial statements for fiscal years beginning on or after October 1, 2007, and must be adopted at the same time, replacing CICA 3861, “Financial Instruments – Disclosure and Presentation”. The Company adopted these standards for its interim and annual financial statements for its fiscal year commencing July 1, 2008. The adoption of these standards did not have a material effect on the Company’s financial statements.

(b) CICA 1535, “Capital Disclosures”

This standard relates to the disclosure of capital management strategies. It applies to interim and annual financial statements for fiscal years beginning on or after October 1, 2007. The Company adopted this standard for its interim and annual financial statements for its fiscal year commencing July 1, 2008. The disclosures required by this standard are presented in Note 21.

(c) CICA 3031, “Inventories”

In June 2007, the CICA issued Section 3031, “Inventories” to replace existing Section 3030. The new section, which is effective January 1, 2008, establishes standards for the measurement and disclosure of inventories. The Company adopted this standard for its interim and annual financial statements for its fiscal year commencing July 1, 2008. The adoption of this standard did not have a material effect on the Company’s financial statements.

(d) CICA 1400, “General Standards of Financial Statement Presentation”

In May 2007, the CICA issued amended Handbook Section 1400, “General Standards of Financial Statement Presentation”. The section provides revised guidance related to management’s responsibility to assess and disclose the ability of an entity to continue as a going concern. This amended standard applies to interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The Company adopted this standard for its interim and annual financial statements for its fiscal year commencing July 1, 2008. The adoption of this standard did not have a material effect on the Company’s financial statements.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

4. 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 consolidated financial statements from October 23, 2007.

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>

5. INVENTORIES

	December 31, 2009	June 30, 2009
Finished goods and work-in-progress	\$ 560,749	\$ 305,187
Raw materials	437,846	329,484
Supplies	112,272	85,328
Returnable containers, net of amortization	245,012	282,456
	<u>\$ 1,355,880</u>	<u>\$ 1,002,455</u>

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

6. PROPERTY AND EQUIPMENT

			December 31, 2009	June 30, 2009
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Computers	\$ 62,166	\$ 43,757	\$ 18,409	\$ 19,710
Equipment	5,766,222	4,087,263	1,678,959	2,088,027
Leasehold improvements	1,289,360	1,025,151	264,209	285,299
Office furniture and fixtures	51,744	40,503	11,241	12,490
Vehicles	519,599	381,898	137,701	162,002
Website	4,825	3,811	1,014	1,192
	<u>\$7,693,916</u>	<u>\$ 5,582,383</u>	<u>\$ 2,111,533</u>	<u>\$ 2,568,720</u>

Equipment includes assets under capital leases with a cost of \$280,654 (June 30, 2009 – \$280,654) and accumulated amortization of \$169,902 (June 30, 2009 – \$150,357). Vehicles includes assets under capital leases with a cost of \$494,694 (June 30, 2009 – \$494,694) and accumulated amortization of \$363,560 (June 30, 2009 – \$340,418).

7. INTANGIBLE ASSETS

		December 31, 2009	June 30, 2009
Brands and trademarks	\$	1,933,316	\$ 1,932,503

8. OTHER ASSETS

		December 31, 2009	June 30, 2009
Restricted 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, 2009 – \$100,000) and another term deposit of \$100,000 has been pledged as security for capital leases (June 30, 2009 – \$100,000).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

9. LONG-TERM DEBT

	December 31, 2009	June 30, 2009
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	\$ -	\$ 17,690
Term loan, bearing interest at 7.8%, repayable in monthly installments of \$18,750 plus interest maturing November 15, 2012, secured by the assets of Fort Garry (i)	656,250	768,750
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 (ii)	1,130,647	1,062,025
	1,786,897	1,848,465
Less: current portion of long-term debt	(225,000)	(242,690)
Long-term portion of long-term debt	\$ 1,561,897	\$ 1,605,775

- (i) On December 8, 2008, the bank made an amendment on the existing term loan in accordance with the request of the Company for six month principal postponement. Pursuant to the amendment, the remaining loan amount on December 8, 2008 of \$787,500 is to be repaid by 42 consecutive monthly principal installments of \$18,750 each commencing June 15, 2009 and ending November 15, 2012. The bank also granted a reduction of the interest rate on the term loan by 1%. With the exception of the amendments agreed, all terms and conditions of the term loan remain unchanged.
- (ii) On December 31, 2007, the Company entered into a loan agreement pursuant to which the lender, a shareholder of the Company, provided a discounted loan to the Company 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 period ended December 31, 2009, the Company recorded interest expense of \$68,622 (2008 - \$60,605) 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 December 31, 2009, the fair value of this early settlement option was estimated to be \$nil.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

9. 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
2010	\$ 112,500
2011	1,190,000
2012	225,000
2013	93,750
	<hr/>
	\$ 1,621,250

10. 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 July 2013. Estimated future minimum lease payments under these capital leases are as follows:

	Amount
Fiscal Year:	
2010	\$ 86,250
2011	106,405
2012	37,499
2013	7,059
Total minimum lease payments	237,213
Less: amount representing interest	(23,471)
Net minimum lease payments	213,742
Less: current portion of capital lease obligations	(140,117)
Long-term portion of capital lease obligations	<hr/>
	\$ 73,625

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

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

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

(b) Issued and Outstanding Share Capital

	Common Shares	Amount
Balance, June 30, 2008	26,660,350	7,847,022
Issued during the year:		
For cash:		
Rights offering, net of share issue costs (ii)	6,665,087	474,110
Balance, June 30, 2009 and December 31, 2009	33,325,437	\$ 8,321,132

- (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 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 CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

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

- (ii) On June 8, 2009 the Company closed a rights offering, whereby 6,665,087 units were issued at a price of \$0.15 per unit. Each unit is comprised of one common share and one non-transferable share purchase warrant. Each warrant entitles the holder to purchase an additional common share of the Company at an exercise price of \$0.25 per common share at any time commencing June 9, 2010 and ending June 8, 2011. Values of \$811,853 and \$187,910 were assigned to the common shares and warrants, respectively, based on their relative fair values at the closing date of the rights offering. In connection with the rights offering, Bolder Investment Partners, Ltd. ("Bolder") acted as managing dealer and standby guarantor for the rights offering. As consideration for acting as managing dealer in the rights offering, the Company paid to Bolder a work fee of \$15,000 plus GST, a managing dealer fee of \$50,000 plus GST and a cash fee equal to \$0.005 per unit subscribed for under the rights offering, other than for units subscribed for by directors and officers of the Company. As consideration for providing the standby guarantee, Bolder received agent unit options from the Company entitling Bolder to acquire up to 1,666,271 units, having the same terms as the units issued under the rights offering. The agent unit options are non transferable, have an exercise price of \$0.15 per unit and will expire twelve months after issue. The fair value of the agent unit options of \$153,217 was charged to share issue costs with an offsetting amount to contributed surplus. The fair values of the warrants and agent unit options issued in connection with this rights offering were computed using the Black-Scholes option-pricing model. As at December 31, 2009, the Company is owed \$42,375 (June 30, 2009 – \$42,375) from two officers and a director of the Company for 282,500 units subscribed under the rights offering (see Note 18(b)).

(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.V. Vesting terms are determined by the board of directors on the date of grant.

Stock option activity since June 30, 2008 is presented below:

	December 31, 2009		June 30, 2009	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of period	2,605,000	\$ 0.41	2,605,000	\$ 0.41
Granted	–	–	–	–
Forfeited	–	–	–	–
Outstanding, ending of period	2,605,000	\$ 0.41	2,605,000	\$ 0.41

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

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

At December 31, 2009, the following stock options are outstanding:

Exercise Price \$	Number of Shares	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Life (in years)	Weighted Average Exercise Price \$	Number of Shares	Weighted Average Exercise Price \$
0.33	715,000	1.28	0.33	715,000	0.33
0.40	1,000,000	3.47	0.40	1,000,000	0.40
0.48	750,000	1.80	0.48	750,000	0.48
0.55	140,000	2.67	0.55	140,000	0.55
	2,605,000	2.35	0.41	2,605,000	0.41

(d) Warrants

Warrant activity since June 30, 2008 is presented below:

	December 31, 2009		June 30, 2009	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of period	6,915,087	\$ 0.26	10,360,894	\$ 0.64
Granted	—	—	6,665,087	0.25
Exercised	—	—	—	—
Expired	(250,000)	0.65	(10,110,894)	0.64
Outstanding, ending of period	6,665,087	\$ 0.25	6,915,087	\$ 0.26

At December 31, 2009, 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
6,665,087 ⁽¹⁾	0.25	June 8, 2011
6,665,087	\$ 0.25	

On December 31, 2009, 250,000 share purchase warrants exercisable at \$0.65 expired unexercised.

(1) 6,665,087 warrants will fully vest on June 9, 2010.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

11. SHARE CAPITAL (continued)**(e) Agent Warrants**

At December 31, 2009, 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 12):

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

(f) Agent Unit Options

Number of Options	Weighted Average Exercise Price	Expiry Date
1,666,271	\$ 0.15	June 11, 2010

12. 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. As at December 31, 2009, the unpaid dividend amount was \$61,200 (June 30, 2009 - \$40,800).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

13. CONTRIBUTED SURPLUS

	December 31, 2009	June 30, 2009
Balance, beginning of period	\$ 3,002,301	\$2,661,174
Relative fair value of warrants issued in rights offering (Note 11)	–	187,910
Fair value of agent unit options issued for share issue costs (Note 11)	–	153,217
Balance, end of period	\$ 3,002,301	\$3,002,301

14. STOCK-BASED COMPENSATION

During the period ended December 31, 2009, the Company granted nil (June 30, 2009 – nil) stock options to directors, officers and consultants of the Company. During the period ended December 31, 2009, the Company recognized \$nil (June 30, 2009 – \$nil) of compensation cost which is included in selling, general and administrative expenses.

15. 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 December 31, 2009, the Company has non-capital losses of approximately \$7,885,000 (2008 - \$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
2010	\$ 801,000
2014	199,000
2015	555,000
2026	243,000
2027	2,139,000
2028	1,675,000
2029	2,273,000
	\$ 7,885,000

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

16. LOSS PER SHARE

The weighted average number of shares outstanding used in the computation of loss per share was 33,325,500 (2008 – 26,660,350). Outstanding stock options, warrants, agent warrants and agent unit options have not been considered in the computation of diluted loss per share as the result is anti-dilutive.

17. SUPPLEMENTAL CASH FLOW INFORMATION

	December 31, 2009	December 31, 2008
Cash paid for:		
Interest	\$ 68,622	\$ 60,605
Income taxes	–	–
Non-cash investing and financing activities:		
Capital lease obligations recognized for assets under capital lease	–	22,933
Common shares issued for services	–	–

18. RELATED PARTY TRANSACTIONS

- (a) During the period ended December 31, 2009, the Company incurred salaries and wages expense of \$74,000 to relatives of directors of the Company (2008 – \$22,917) and consulting fees of \$24,000 to a director of the Company (2008 – \$24,000). These transactions were in the normal course of operations and have been recorded at their exchange amounts, which is the consideration agreed upon by the related parties.
- (b) As at December 31, 2009, the Company is owed \$42,375 from two officers and a director of the Company (see Note 11(b)(ii)). The amounts are non-interest bearing, unsecured and due on demand.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

19. 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 December 31, 2009 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. As at December 31, 2009, the Company has significant accounts receivable from one major customer totalling \$210,669 (June 30, 2009 - \$504,738). The Company manages credit risk for trade and other receivables through established credit monitoring activities. As at December 31, 2009, the Company's maximum exposure to credit risk is the carrying value of cash and cash equivalents, accounts receivable and other assets.

(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 cash flow risk as they carry variable rates of interest. A plus or minus 1% change in market interest rates would not have a significant effect on the Company's loss and comprehensive loss for the period.

20. 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>
2010	\$ 180,457
2011	366,168
2012	360,081
2013	338,748
2014	256,983
Thereafter	206,364
	<u>\$ 1,708,801</u>

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS****FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008**

20. COMMITMENTS AND CONTINGENCIES (continued)

- (b) As at December 31, 2009, the Company had issued a general excise bond of \$55,000 in favour of the Minister of National Revenue of Canada.
- (c) The Company has a bank operating line of credit with a limit of \$100,000 which bears interest at prime, matures on August 31, 2010 and is secured by a term deposit of \$100,000 (see Note 8).

21. CAPITAL MANAGEMENT

The Company manages its capital structure in order to ensure sufficient resources are available to meet operational requirements. The Company is required to maintain term deposits of \$200,000 (2008 - \$200,000) related to its bank line of credit and capital losses (see Note 8). There are no other externally imposed capital requirements.

The Company seeks to manage capital to provide adequate funding for its operations while minimizing dilution for its existing shareholders. The Company's principal source of funds is from the issuance of common shares and warrants.

Management considers its shareholders' equity, long-term debt and capital leases as capital, which consists of the following:

	December 31, 2009	June 30, 2009
Long-term debt	\$ 1,786,897	\$ 1,848,465
Capital lease obligations	213,742	283,601
Shareholders' equity	3,263,167	3,802,949
	<hr/> \$ 5,263,806	<hr/> \$ 5,935,015