
RUSSELL BREWERIES INC.
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED
JUNE 30, 2010 AND 2009



MANNING ELLIOTT
CHARTERED ACCOUNTANTS

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AUDITORS' REPORT

To the Shareholders of
Russell Breweries Inc.

We have audited the consolidated balance sheets of Russell Breweries Inc. as at June 30, 2010 and 2009 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Manning Elliott LLP

Chartered Accountants
Vancouver, British Columbia
October 28, 2010

RUSSELL BREWERIES INC.
CONSOLIDATED BALANCE SHEETS
AS AT JUNE 30, 2010 AND 2009

	2010	2009 (Note 4)
ASSETS		
CURRENT		
Cash and cash equivalents	\$ 42,552	\$ 488,616
Accounts receivable	961,274	1,205,988
Inventories (Note 5)	1,211,903	1,002,455
Prepaid expenses and deposits	117,690	267,395
Due from related parties (Note 18(b))	45,392	42,375
	2,378,811	3,006,829
PROPERTY AND EQUIPMENT (Note 6)	3,652,166	4,045,941
INTANGIBLE ASSETS (Note 7)	1,933,653	1,932,503
DEFERRED FINANCING COSTS	19,832	-
OTHER ASSETS (Note 8)	200,000	200,000
	\$ 8,184,462	\$ 9,185,273
LIABILITIES		
CURRENT		
Bank indebtedness (Note 20(c))	\$ 136,534	\$ -
Accounts payable and accrued liabilities	2,113,826	1,732,237
Dividend payable (Note 13)	81,600	40,800
Demand loan (Note 9)	125,000	-
Current portion of long-term debt (Note 10)	1,314,209	242,690
Current portion of capital lease obligations (Note 11)	97,395	158,848
	3,868,564	2,174,575
LONG-TERM DEBT (Note 10)	399,750	1,605,775
CAPITAL LEASE OBLIGATIONS (Note 11)	41,842	124,753
	4,310,156	3,905,103
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 12)	8,321,132	8,321,132
EXCHANGEABLE PREFERRED SHARES (Note 13)	518,979	518,979
CONTRIBUTED SURPLUS (Note 14)	3,002,301	3,002,301
DEFICIT	(7,968,106)	(6,562,242)
	3,874,306	5,280,170
	\$ 8,184,462	\$ 9,185,273

NATURE OF OPERATIONS AND CONTINUANCE OF BUSINESS (Note 1)
 COMMITMENTS AND CONTINGENCIES (Note 20)
 SUBSEQUENT EVENTS (Note 23)

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.**CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	2010	2009 (Note 4)
REVENUES (Note 22)	\$ 8,224,740	\$ 7,189,052
LESS: EXCISE TAX AND PROVINCIAL MARK-UP	2,018,386	1,615,031
NET REVENUES	6,206,354	5,574,021
COST OF SALES	3,432,829	2,918,671
GROSS MARGIN	2,773,525	2,655,350
EXPENSES		
Amortization	486,131	564,790
Selling, general and administrative (Note 18(a))	3,519,681	3,539,284
	4,005,812	4,104,074
LOSS BEFORE OTHER INCOME (EXPENSE)	(1,232,287)	(1,448,724)
OTHER INCOME (EXPENSE)		
Interest on long-term debt	(174,117)	(238,625)
Interest income	(724)	10,504
Other income	34,231	38,944
Gain on settlement of accounts payable	7,833	-
	(132,777)	(189,177)
NET LOSS AND COMPREHENSIVE LOSS FOR THE YEAR	(1,365,064)	(1,637,901)
DEFICIT, BEGINNING OF YEAR, AS PREVIOUSLY REPORTED	(8,039,463)	(5,821,374)
RESTATEMENT FOR CHANGE IN ACCOUNTING POLICY (Note 4)	1,477,221	937,833
DEFICIT, BEGINNING OF YEAR, AS RESTATED	(6,562,242)	(4,883,541)
DIVIDENDS (Note 13)	(40,800)	(40,800)
DEFICIT, END OF YEAR	\$ (7,968,106)	\$ (6,562,242)
LOSS PER SHARE (Note 16)		
Basic and diluted	\$ (0.04)	\$ (0.06)

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

RUSSELL BREWERIES INC.**CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	2010	2009 (Note 4)
CASH FLOWS PROVIDED BY (USED FOR):		
OPERATING ACTIVITIES		
Net loss for the year	\$ (1,365,064)	\$ (1,637,901)
Adjusted for non-cash items:		
Amortization	486,131	564,790
Accretion of long-term debt	108,185	124,074
Stock-based compensation expense	—	—
	(770,748)	(949,037)
Net changes in non-cash working capital items:		
Accounts receivable	244,714	(445,671)
Prepaid expenses and deposits	149,705	4,213
Inventories	(259,908)	(213,710)
Deferred financing costs	(19,832)	—
Due to and from related parties	(3,017)	—
Accounts payable and accrued liabilities	381,589	715,009
	(277,497)	(889,196)
INVESTING ACTIVITIES		
Purchases of property and equipment	(41,896)	(89,736)
Purchases of intangible assets	(1,150)	(2,660)
	(43,046)	(92,396)
FINANCING ACTIVITIES		
Proceeds from issuance of common shares and warrants, net of cash share issuance costs	—	772,863
Proceeds from bank indebtedness	136,534	—
Repayment of long-term debt	(242,691)	(143,754)
Repayment of capital lease obligations	(144,364)	(149,418)
Proceeds from demand loan	125,000	—
	(125,521)	479,691
DECREASE IN CASH AND CASH EQUIVALENTS	(446,064)	(501,901)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	488,616	990,517
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 42,552	\$ 488,616
CASH AND CASH EQUIVALENTS CONSIST OF:		
Demand deposits	\$ 42,552	\$ 488,616

SUPPLEMENTAL CASH FLOW INFORMATION (Note 17)

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

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

1. NATURE OF OPERATIONS AND CONTINUANCE OF BUSINESS

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").

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. As at June 30, 2010, the Company had a working capital deficiency of \$1,489,753 and accumulated losses since inception of \$7,968,106. These factors raise substantial doubt about the Company's ability to continue as a going concern. The continued operation of the Company is dependent on its ability to obtain financing sufficient to generate profitable operations in the future. There is no guarantee that the Company will be able to raise this additional financing.

On October 5, 2010, the Company announced financings of \$1,000,000 in the form of convertible debentures and \$1,000,000 in the form of equity units consisting of common shares and warrants to purchase common shares of the Company (see Note 23). As at October 28, 2010, the Company had received \$nil proceeds relating to these financings as amounts received under subscription agreements were being held in trust subject to certain closing conditions. There is no guarantee that these financings will close subsequent to the issuance of these financial statements.

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 subsidiaries Russell Brewing Company Ltd. ("Russell") and Fort Garry Brewing Company Ltd. ("Fort Garry"). All significant inter-company balances and transactions have been eliminated upon consolidation.

Certain of the comparative figures have been restated as the Company has changed its accounting policy for the amortization of property and equipment (see Note 4).

(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, disclosures of contingent liabilities and fair value measurements. Actual results may differ from those estimates.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

2. SIGNIFICANT ACCOUNTING POLICIES (continued)**(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) 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.

(iii) Bank Indebtedness

Bank indebtedness is designated as held-for-trading and is recorded at fair value with gains and losses recorded in the statement of operations.

(iv) Demand Loan

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

(v) 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.

(vi) 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.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

2. SIGNIFICANT ACCOUNTING POLICIES (continued)**(e) Property and Equipment****(i) Amortization Methods and Rates**

Property and equipment is recorded at cost less accumulated amortization. Amortization is calculated using the straight-line method over the useful lives of the assets which are estimated as follows:

Computers hardware and software	2-4	Years
Equipment	7-25	Years
Office furniture and equipment	5	Years
Vehicles	10	Years
Website	3	Years

Leasehold improvements are amortized using the straight-line method over the estimated 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.

(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 impairment charge 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.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

2. SIGNIFICANT ACCOUNTING POLICIES (continued)**(h) Stock-Based Compensation**

The Company has a plan for granting stock options to management, directors, employees and consultants as described in Note 12(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.

(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."

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

2. SIGNIFICANT ACCOUNTING POLICIES (continued)**(k) Recent Accounting Pronouncements (continued)****(i) CICA 1582, "Business Combinations", CICA 1601, "Consolidated Financial Statements" and CICA 1602, "Non-Controlling Interests" (continued)**

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 3251, "Equity"

In August 2009, Section 3251 Equity was issued in response to issuing Section 1602 Non-controlling Interests. The amendments require non-controlling interests to be recognized as a separate component of equity. The amendments apply only to entities that have adopted Section 1602. The adoption of this section is not expected to have a material impact on the financial statements.

(iii) CICA 1625, "Comprehensive Revaluation of Assets and Liabilities"

In August 2009, Section 1625 Comprehensive Revaluation of Assets and Liabilities was issued for consistency with new Section 1582 Business Combinations. The amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011. The adoption of this section is not expected to have a material impact on the financial statements.

(iv) 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 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. The Company adopted this standard for its interim and annual financial statements for its fiscal year commencing July 1, 2009. The adoption of this standard did not have a material effect on the Company's financial statements.

(b) CICA 3862, "Financial Instruments – Disclosures"

During the year, the CICA amended Section 3862 to enhance fair value and liquidity disclosures. The standard now requires that all financial instruments measured at fair value be categorized into one of three hierarchy levels. Each level is based on the transparency of inputs to the valuation of the financial asset or liability as of the measurement date. The adoption of this standard did not have a material effect on the consolidated financial statements. The disclosures required by this amendment are disclosed in Note 19(b).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

3. ADOPTION OF NEW ACCOUNTING STANDARDS (continued)**(c) CICA 3855, "Financial Instruments – Recognition and Measurement"**

During the year, the CICA amended Section 3855 to bring greater consistency between Canadian GAAP, IFRS and US GAAP regarding the timing of impairment recognition for debt instruments. The amendments allow more debt instruments to be classified as loans and receivables. In addition, the amendments require reversal of previously recognized impairment losses on available-for-sale financial assets in specified circumstances and require that loans and receivables that an entity intends to sell immediately or in the near term be classified as held for trading. The transitional provisions are complex and are accompanied by disclosure requirements to explain any reclassifications made on adopting the amendments.

4. CHANGE IN ACCOUNTING POLICY

During the year ended June 30, 2010, the Company determined that it was more appropriate to recognize amortization of property and equipment using the straight-line method as it better reflected the economic usage of the related assets. The Company previously recognized amortization using the declining balance method. As a result of the change in accounting policy, the comparative financial statements for the year ended June 30, 2009 have been restated as follows:

	As Previously Reported	Change	As Restated
Statement of Operations:			
Amortization	\$ 1,104,178	\$ (539,388)	\$ 564,790
Net loss	2,177,289	(539,388)	1,637,901
Loss per share – basic and diluted	(0.08)	(0.02)	(0.06)
Deficit, beginning of year	5,821,374	(937,833)	4,883,541
Deficit, end of year	8,039,463	(1,477,221)	6,562,242
Balance Sheet:			
Property and equipment	2,568,720	1,477,221	4,045,941
Deficit	\$ 8,039,463	\$(1,477,221)	\$ 6,562,242

5. INVENTORIES

	2010	2009
Finished goods and work-in-progress	\$ 396,682	\$ 305,187
Raw materials	521,788	329,484
Supplies	63,911	85,328
Returnable containers, net of amortization	229,522	282,456
	\$ 1,211,903	\$ 1,002,455

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

6. PROPERTY AND EQUIPMENT

			2010	2009
	Cost	Accumulated Amortization	Net Book Value	Net Book Value (Note 4)
Computers	\$ 67,235	\$ 64,926	\$ 2,309	\$ 8,118
Equipment	5,767,680	2,529,767	3,237,913	3,533,251
Leasehold improvements	1,299,337	1,167,703	131,634	168,160
Office furniture and fixtures	51,744	47,634	4,110	8,336
Vehicles	519,599	243,484	276,115	328,076
Website	5,975	5,890	85	-
	\$7,711,570	\$ 4,059,404	\$3,652,166	\$ 4,045,941

Equipment includes assets under capital leases with a cost of \$280,654 (2009 – \$280,654) and accumulated amortization of \$46,821 (2009 – \$32,788). Vehicles includes assets under capital leases with a cost of \$494,694 (2009 – \$494,694) and accumulated amortization of \$212,574 (2009 – \$163,104) (see Note 4).

7. INTANGIBLE ASSETS

	2010	2009
Brands and trademarks	\$ 1,933,653	\$ 1,932,503

8. OTHER ASSETS

	2010	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 (2009 – \$100,000) and another term deposit of \$100,000 has been pledged as security for capital leases (2009 – \$100,000).

9. DEMAND LOAN

On June 18, 2010, the Company entered into a loan facility agreement with a primary lender under which the lender and its partners may advance up to \$500,000 to the Company at their discretion. The purpose of the loan is to finance amounts receivable from the British Columbia Liquor Distribution Branch. Amounts advanced bear interest at the lesser of 2% of the average loan balance during the month and 2% of the proceeds advanced under the agreement. The loan is repayable on demand and is secured by a general security agreement of the assets of the Company and by specific assignment of a joint signing account. As at June 30, 2010, \$125,000 has been advanced under this agreement. On July 5, 2010, an additional \$250,000 was advanced (see Note 23(a)).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

10. LONG-TERM DEBT

	2010	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 bank loan, bearing interest at 7.8%, repayable in monthly installments of \$18,750 plus interest prior to October 2010 and \$9,750 plus interest thereafter maturing November 15, 2014, secured by the assets of Fort Garry (a)	543,750	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 (b)	1,170,209	1,062,025
	1,713,959	1,848,465
Less: current portion of long-term debt	(1,314,209)	(242,690)
Long-term portion of long-term debt	\$ 399,750	\$1,605,775

- (a) On December 8, 2008, the bank made an amendment to 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 was 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. On September 22, 2010, the bank made a further amendment to the existing term loan in accordance with the request of the Company. Pursuant to the amendment, the remaining loan amount is to be repaid by 50 consecutive monthly principal installments of \$9,750 each commencing October 15, 2010 and ending November 15, 2014.
- (b) 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 year ended June 30, 2010, the Company recorded interest expense of \$108,185 (2009 - \$124,074) 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 June 30, 2010, the fair value of this early settlement option was estimated to be \$nil.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

10. LONG-TERM DEBT (continued)

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

<u>Fiscal Year</u>	<u>Amount</u>
2011	\$ 1,109,000
2012	117,000
2013	117,000
2014	117,000
2015	48,750
	<u>\$ 1,508,750</u>

11. 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:

	<u>Amount</u>
Fiscal Year:	
2011	\$ 120,383
2012	37,499
2013	7,059
Total minimum lease payments	164,941
Less: amount representing interest	(25,704)
Net minimum lease payments	139,237
Less: current portion of capital lease obligations	(97,395)
Long-term portion of capital lease obligations	<u>\$ 41,842</u>

12. 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

	<u>Common Shares</u>	<u>Amount</u>
Balance, June 30, 2008	26,660,350	\$ 7,847,022
Issued during the year:		
For cash:		
Rights offering, net of share issue costs	6,665,087	474,110
Balance, June 30, 2009 and 2010	<u>33,325,437</u>	<u>\$ 8,321,132</u>

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

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

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 June 30, 2010, the Company is owed \$42,375 (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:

	2010		2009	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	2,605,000	\$ 0.41	2,605,000	\$ 0.41
Forfeited	(360,000)	0.41	—	—
Outstanding, ending of year	2,245,000	\$ 0.41	2,605,000	\$ 0.41

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

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

At June 30, 2010, 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 \$
0.33	625,000	0.79	0.33	625,000	0.33
0.40	880,000	2.97	0.40	880,000	0.40
0.48	600,000	1.31	0.48	600,000	0.48
0.55	140,000	2.17	0.55	140,000	0.55
	2,245,000	1.87	0.41	2,245,000	0.41

(d) Warrants

Warrant activity since June 30, 2008 is presented below:

	2010		2009	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	6,915,087	\$ 0.26	10,360,894	\$ 0.64
Granted	—	—	6,665,087	0.25
Expired	(250,000)	0.65	(10,110,894)	0.64
Outstanding, ending of year	6,665,087	\$ 0.25	6,915,087	\$ 0.26

At June 30, 2010, 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	0.25	June 8, 2011

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

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

On March 31, 2010, 6,800 agent warrants exercisable into 113,333 common shares of the Company at \$0.60 per share expired unexercised. As at June 30, 2010, no agent warrants were outstanding (2009 – 6,800).

(f) Agent Unit Options

On June 11, 2010, 1,666,271 agent unit options at \$0.15 expired unexercised. As at June 30, 2010, no agent unit options were outstanding (2009 – 1,666,271).

13. 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 June 30, 2010, the unpaid dividend amount was \$81,600 (2009 - \$40,800).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

14. CONTRIBUTED SURPLUS

	2010	2009
Balance, beginning of year	\$3,002,301	\$2,661,174
Relative fair value of warrants issued in rights offering (Note 12(b))	–	187,910
Fair value of agent unit options issued for share issue costs (Note 12(b))	–	153,217
Balance, end of year	\$3,002,301	\$3,002,301

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 income tax assets will not be realized. The ultimate realization of future income 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 income tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of future income tax assets considered realizable could change materially in the near term based on future taxable income during the loss carry-forward period.

(a) Future Income Tax Assets and Liabilities

The significant components of the Company's future income tax assets and liabilities are as follows:

	2010	2009 (Note 4)
Future income tax assets (liabilities):		
Non-capital losses carried forward	\$ 2,171,000	\$ 2,017,000
Tax value of property and equipment in excess of book value	188,000	(39,000)
Book value of intangible assets in excess of tax value	(425,000)	(429,000)
Share issue costs available to be deducted for tax purposes	86,000	154,000
Accounting reserves not deducted for tax purposes	19,000	20,000
Other	3,000	3,000
	2,042,000	1,726,000
Valuation allowance	(2,042,000)	(1,726,000)
Net future income tax assets	\$ –	\$ –

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

15. INCOME TAXES (continued)**(b) Non-Capital Losses Carried Forward and Expiration Dates**

As at June 30, 2010, the Company has non-capital losses of approximately \$8,566,000 (2009 - \$7,885,000) 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
2014	\$ 157,000
2015	295,000
2026	257,000
2027	2,125,000
2028	1,696,000
2029	2,213,000
2030	1,823,000
	<u>\$ 8,566,000</u>

(c) Reconciliation of Tax Rates

The Company is subject to Canadian federal and provincial taxes at an approximate rate of 29.25% (2009 – 30.50%). The reconciliation of the provision for income taxes at the statutory rate compared to the Company's income tax expense as reported is as follows:

	2010	2009 (Note 4)
Loss before income taxes	\$ 1,365,064	\$ 1,637,901
Statutory tax rate	29.25%	30.50%
Expected income tax recovery at statutory rates	399,000	500,000
Permanent differences	(51,000)	(388,000)
Change in valuation allowance	(316,000)	(31,000)
Changes in tax rates	22,000	9,000
Changes in estimates and other	(54,000)	(90,000)
Income tax recovery	\$ –	\$ –

16. LOSS PER SHARE

Net loss available to common shareholders in the computation of loss per share is as follows:

	2010	2009
Net loss and comprehensive loss	\$ (1,365,064)	\$ (1,637,901)
Dividends on exchangeable preferred shares	(40,800)	(40,800)
Net loss available to common shareholders	<u>\$ (1,405,864)</u>	<u>\$ (1,678,701)</u>

The weighted average number of shares outstanding used in the computation of loss per share was 34,458,770 (2009 – 28,195,415). 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.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

17. SUPPLEMENTAL CASH FLOW INFORMATION

	2010	2009
Cash paid for:		
Interest	\$ 65,932	\$ 114,550
Income taxes	-	-
Non-cash investing and financing activities:		
Capital lease obligations recognized for assets under capital lease	\$ -	\$ 22,933

18. RELATED PARTY TRANSACTIONS AND BALANCES

- (a) During the year ended June 30, 2010, the Company incurred salaries and wages expense of \$156,018 to relatives of directors of the Company (2009 – \$63,669) and salaries of \$48,000 to a director of the Company (2009 – \$63,000 in consulting fees). 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 June 30, 2010, the Company is owed \$45,392 (2009 – \$42,375) (see Note 12(b)) from two officers and a director of the Company. The amounts are non-interest bearing, unsecured and due on demand.

19. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS**(a) Fair Values of Financial Instruments**

The carrying values of cash and cash equivalents, accounts receivable, due from related parties, other assets, bank indebtedness, accounts payable, dividend payable and demand loan are reasonable estimates of fair values due to the relatively short periods to maturity and the commercial terms of these instruments. The carrying values of long-term debt and capital lease obligations at June 30, 2010 are considered to be reasonable estimates of fair value based on current market rates for similar financial instruments.

(b) Fair Value Measurements

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

Level 1 - Quoted Prices in Active Markets for Identical Assets

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

Cash equivalents and bank indebtedness, when applicable, are valued using quoted market prices. Accordingly, these items are included in Level 1 of the fair value hierarchy.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

**19. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS
(continued)****(b) Fair Value Measurements (continued)**

Level 2 - Significant Other Observable Inputs

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

Derivative instruments are included in Level 2 of the fair value hierarchy as they are valued using pricing models or discounted cash flow models. These models require a variety of inputs, including, but not limited to, contractual terms, market prices, forward price curves, yield curves, and credit spreads. These inputs are obtained from or corroborated with the market where possible.

Level 3 - Significant Unobservable Inputs

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

Financial liabilities measured at fair value on a recurring basis were presented on the Company's balance sheet as of June 30, 2010 as follows:

	Fair Value Measurements Using			Balance as of June 30, 2010
	Quoted Prices in Active Markets For Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	\$	\$	\$	\$
Assets:				
Cash and cash equivalents	42,552	—	—	42,552
Liabilities:				
Bank indebtedness	136,534	—	—	136,534

(c) Financial Risks**(i) Credit Risk**

Credit risk arises from the non-performance by counterparties of contractual financial obligations. The Company maintains substantially all of its cash and cash equivalents and 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 June 30, 2010, the Company has significant accounts receivable from one major customer totalling \$258,941 (2009 - \$504,738). The Company manages credit risk for trade and other receivables through established credit monitoring activities. As at June 30, 2010, the Company's maximum exposure to credit risk is the carrying value of cash and cash equivalents, accounts receivable, due from related parties and other assets.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

19. FINANCIAL INSTRUMENTS, FAIR VALUE MEASUREMENTS AND FINANCIAL RISKS**(continued)****(c) Financial Risks (continued)****(ii) Liquidity Risk**

Liquidity risk arises from the Company's general and capital financing needs. The Company continuously monitors and reviews both actual and forecasted cash flows, and also matches the maturity profile of financial assets and liabilities, when feasible.

Contractual undiscounted cash flow requirements for financial liabilities as at June 30, 2010 are as follows:

	Less Than 1 Year \$	Years 2 and 3 \$	Years 4 and 5 \$	More Than 5 Years \$	Total \$
Bank indebtedness	136,534	—	—	—	136,534
Accounts payable and accrued liabilities	2,113,826	—	—	—	2,113,826
Dividend payable	122,400	—	—	—	122,400
Demand loan	125,000	—	—	—	125,000
Long-term debt	1,383,000	234,000	165,750	—	1,782,750
Capital lease obligations	120,383	44,558	—	—	164,941
	4,001,143	278,558	165,750	—	4,445,451

As at June 30, 2010, the Company had a working capital deficiency of \$1,489,753. On October 5, 2010, the Company announced financings with anticipated proceeds totalling \$2,000,000 (see Notes 1 and 23).

(iii) Interest Rate Price Risk

The Company's cash equivalents, when held, are subject to interest rate price risk as they carry fixed rates of interest. 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.

(iv) Interest Rate Cash Flow Risk

Certain of the Company's long-term debt instruments and bank indebtedness 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 year.

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

20. COMMITMENTS AND CONTINGENCIES

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

<u>Fiscal Year</u>	<u>Amount</u>
2011	394,997
2012	391,073
2013	335,323
2014	225,422
2015	231,048
	<u>\$ 1,577,863</u>

- (b) As at June 30, 2010, 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 (2009 - \$200,000) related to its bank line of credit and capital leases (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:

	2010	2009 (Note 4)
Long-term debt	\$ 1,713,959	\$ 1,848,465
Capital lease obligations	139,237	283,601
Shareholders' equity	3,874,306	5,280,170
	<u>\$ 5,727,502</u>	<u>\$ 7,412,236</u>

22. MAJOR CUSTOMER

During the year ended June 30, 2010, the Company had sales of \$3,945,000 (2009 – \$3,691,000) to the Manitoba Liquor Control Commission which accounted for 48% of its gross revenues (2009 – 51%).

RUSSELL BREWERIES INC.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

23. SUBSEQUENT EVENTS

- (a) On July 5, 2010, the Company received an advance of \$250,000 from a partner of the primary lender of the demand loan described in Note 9. This advance is subject to terms and conditions of the loan facility agreement entered into on June 17, 2010 and accordingly, bears interest at the lesser of 2% of the average loan balance during the month and 2% of the proceeds advanced under the agreement. The loan is repayable on demand and is secured by a general security agreement of the assets of the Company and by specific assignment of a joint signing account.
- (b) On September 22, 2010, the bank made an amendment to the existing term loan described in Note 10(a) in accordance with the request of the Company. Pursuant to the amendment, the remaining loan amount is to be repaid in 50 consecutive monthly installments of \$9,750 each commencing October 15, 2010 and ending November 15, 2014.
- (c) On October 5, 2010, the Company announced a non-brokered private placement of an aggregate of \$1,000,000 principal amount of convertible debentures (the "Convertible Debentures") and a non-brokered private placement of units (the "Units") at a price of \$0.08 per Unit for additional proceeds of up to \$1,000,000. The Convertible Debentures will mature on the date that is two years from the date of issuance and bear interest at 10% per annum, payable quarterly. The principal amount of the Convertible Debentures is convertible into common shares of the Company, at any time from the date of issuance until the maturity date, at a price equal to \$0.15 per common share. Each Unit will consist of one common share and one share purchase warrant (a "Warrant"), each Warrant entitling the holder to purchase one additional common share at a price of \$0.15 per common share for a period of two years from the date of issuance.

On October 25, 2010, the Company announced that the non-brokered private placements described above would now be conducted as brokered private placements and that the aggregate amount of up to \$2,000,000 will be raised from the sale of the Convertible Debentures and the Units, in any combination thereof. A commission of 10% of the total gross proceeds realized from the Offerings is payable in cash together with that number of agent's warrants (the "Agent's Warrants") as is equal to 12% of the number of Units and 12% of the number of common shares underlying the Convertible Debentures sold pursuant to the Offerings. Each Agent's Warrant entitles the holder, on exercise, to purchase one unit on the same terms as the Units, at a price of \$0.08 per unit. The Agent will also receive a corporate finance fee of 625,000 common shares.

As at October 28, 2010, the Company had received \$nil proceeds relating to this financing as amounts received under subscription agreements were being held in trust subject to certain closing conditions. There is no guarantee that this financing will close subsequent to the issuance of these financial statements.

- (d) On October 18, 2010, the Company granted 100,000 stock options pursuant to its stock option plan, exercisable for up to five years at a price of \$0.10 per share.

RUSSELL BREWERIES INC.
Management Discussion and Analysis
For the year ended June 30, 2010

The following discussion and analysis prepared as of October 28, 2010 should be read in conjunction with the audited consolidated financial statements and related notes and Management Discussion and Analysis and for the fiscal years ended June 30, 2010 and 2009.

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 subsidiaries, Russell Brewing Company Ltd. located in Surrey, BC and Fort Garry Brewing Company Ltd. located in Winnipeg, Manitoba, Russell Breweries Inc. ("the Company") operates two craft breweries producing premium quality beers for pubs, restaurants and liquor stores. The Company acquired Fort Garry Brewing Company Ltd. ("Fort Garry") on October 22, 2007. Fort Garry is Manitoba's largest brewer and distributor of premium quality beers. The Company's operations include production facilities in Surrey, BC and Winnipeg, Manitoba, corporate offices in Surrey, BC, storage facilities, brewing equipment, and delivery and sales vehicles. The breweries 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, Fort Garry Dark Ale, Fort Garry Pale Ale, Fort Garry Premium Light, Fort Garry Red and Stone Cold Lager.

BUSINESS DEVELOPMENTS AND SIGNIFICANT EVENTS

The Company acquired Fort Garry Brewing Company Ltd. ("Fort Garry") on October 22, 2007 - see Acquisition of Fort Garry contained in the next section.

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.

On March 31, 2008, the Company's wholly-owned subsidiary, Russell Brewing Company Ltd. ("RBC"), completed a brokered private placement for 68,000 Exchangeable Non-Voting Preferred Shares (the "Exchangeable Shares") at a price of \$10.00 per Exchangeable Share, raising gross proceeds of \$680,000. RBC used the net cash proceeds of \$540,375, after cash issuance costs totaling \$139,625, for equipment purchases and for general working capital – see Liquidity and Resources: Cash Flow.

On May 9, 2008, RBC expanded distribution to Winnipeg, Manitoba. Draught products available include Russell Cream Ale, Russell Honey Blonde Ale and Russell Lemon Ale. Packaged products available for retail through the MLCC stores include 355ml six-pack cans of Russell Cream Ale and Russell Honey Blonde.

On July 15, 2008, the Company acquired additional 7,000 sq ft of office and warehouse space in Surrey BC. The new facility, located at 81Ave and 130 Street will be used for storage of finished goods and as a logistics and distribution center for British Columbia. The new space will enable the Company to expand its capacity from 16,000 hectolitres to 25,000 hectolitres. This new space will be perfect for the Company with excellent loading bays and road access. The net result will be increased savings in our logistics department through improved efficiencies.

On August 5, 2008, the Company commenced shipping 6x355 ml cans of its award-winning Cream Ale to the Government operated BC liquor stores throughout British Columbia.

On January 13, 2009, the Company launched a 12 can pack – a collection of the four signature beers. Russell Premium Craft Collection pack includes: Extra Special Lager, Pale Ale, Honey Blonde Ale and our award winning Cream Ale.

RUSSELL BREWERIES INC.
Management Discussion and Analysis
For the year ended June 30, 2010

BUSINESS DEVELOPMENTS AND SIGNIFICANT EVENTS (continued)

On May 5, 2009, the Company launched a new series of small-batch limited release beers. The first in the series is a classic India Pale Ale named - Russell IP'eh!

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 for gross proceeds of \$999,763. 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 – see Liquidity and Resources: Cash Flow.

On June 15, 2009, the Company launched six pack bottles of new Cactus Lime Lager for immediate distribution in the provinces of British Columbia and Manitoba. On June 22, 2009, the Company launched bottles of its very popular summer draught beer, Russell Lemon Ale. Russell Lemon Ale is filtered wheat ale infused with natural lemon essence.

On June 25, the Company re-launched the BC Lions Lager for the 2009 football season. BC Lions Lager is a signature beer that was developed for the BC Lions Football Club by the Company. The proprietary beer brand is a landmark partnership between a CFL football team and a microbrewery.

On September 3, 2009, the Company commenced distribution in Alberta with the introduction of the award winning Russell Cream Ale and Cactus Lime Lager in all Cactus Club Cafe's as well as distribution of the Cactus Lime Lager in Liquor Depot and Liquor Barn outlets.

On September 8, 2009, the Company was awarded sixth place on Business in Vancouver's ("BIV") top 100 fastest – growing companies for 2009.

On September 25, 2009, the Company was awarded three medals at Canadian Brewing Awards Gala in Toronto for brands from its regional breweries - Russell Brewing Company ("RBC") in British Columbia and Fort Garry Brewing ("Fort Garry") in Manitoba. A silver medal was awarded to RBC in the North American Style Blonde/Golden Ale category for the Russell Honey Blonde Ale and a bronze medal awarded in the North American Style Lager category for its Rocky Mountain Pilsner. A silver medal was awarded to Fort Garry in the North American Dark Lager category for Fort Garry Rouge. Judging of the awards was registered by the Beer Judge Certification Program (BJCP) which certifies and ranks beer judges through examination and monitoring processes.

On October 6, 2009, the Company signed a five year beer sponsorship agreement with Global Spectrum Facility Management, L.P., the agent on behalf of the City of Abbotsford and the operator and manager of the Abbotsford Entertainment and Sports Centre.

On December 17, 2009, the Company began shipping 6 pack bottles of Chambar Ale as part of its co-packing agreement with Chambar Restaurant to produce a Belgian style beer for the take home market. Chambar Ale is now available in 6 pack bottles in Vancouver through select restaurants and boutique liquor retailers including: Brewery Creek (3045 Main Street, Vancouver), Steamworks (375 Water Street, Vancouver), Broadway Cold Beer & Wine Store (1159 Broadway, Vancouver) and Taylors Crossing (1015 Marine Drive, North Vancouver).

On April 10, 2010, the Company claimed two medals at the Brewers Association (BA) World Beer Cup 2010, a global beer competition that evaluates beers from around the world and recognizes the most outstanding beers being produced in the world today. The Company received a bronze medal in the English-Style India Pale Ale beer style category for its Russell IP'EH! plus a bronze medal in the Scottish-Style Pale Ale category for its Wee Angry Scottish Ale. World Beer Cup 2010 winners were selected by an international panel of 179 beer judges from 27 countries. An impressive field of 3,401 entries from 642 breweries in 44 countries made up the competition. More than 3,800 breweries in 100 countries were invited to compete.

In October 2010, the Company claimed a silver medal for the Russell Brewmaster Series beer, 'A Wee Angry Scotch Ale' at the 8th annual Canadian Brewing Awards (CBA) in Toronto.

RUSSELL BREWERIES INC.
Management Discussion and Analysis
For the year ended June 30, 2010

BUSINESS DEVELOPMENTS AND SIGNIFICANT EVENTS (continued)

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 Fort Garry Brewing Company Ltd. On July 27, 2007, the Company completed a Definitive Agreement with Fort Garry.

Effective October 22, 2007, the Company acquired all the issued 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 shares of Fort Garry were de-listed effective October 22, 2007.

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. The comparative figures for the consolidated balance sheet presented as at June 30, 2009 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 nine months ended March 31, 2009 include the results of operations of Fort Garry from July 1, 2008.

Acquired intangible assets at fair market value consist of brands and trademarks of \$1,928,043.

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.

Acquisition of Fort Garry Brewing Company		
Allocation of Purchase Price to the Fair Value of Net Assets		
Current assets	\$ 883,875	14%
Capital assets	2,862,781	46%
Intangible assets	1,928,043	32%
Future income tax assets	507,698	8%
Fair value of assets acquired	6,182,397	100%
Current liabilities	508,035	26%
Long term liabilities	918,750	46%
Capital leases obligations	35,612	2%
Future income tax liabilities	507,698	26%
Fair value of liabilities assumed	1,970,095	100%
Purchase price	\$ 4,212,302	

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BUSINESS DEVELOPMENTS AND SIGNIFICANT EVENTS (continued)

Acquisition of Fort Garry (continued)

Acquisition of Fort Garry Brewing Company		
Consideration given:		
Cash for Fort Garry common shares and redemption of preferred shares	\$ 1,262,973	30%
4,203,566 Russell common shares for Fort Garry common shares	2,518,318	60%
Consideration given to Fort Garry common and preferred Shareholders	3,781,291	90%
Transaction costs	431,011	10%
Purchase price	\$ 4,212,302	100%

SELECTED ANNUAL INFORMATION

The following table presents selected financial information for the last three fiscal years ended June 30, 2010, 2009 and 2008:

Selected Annual Information	Year Ended 30- June-10	Year Ended 30-Jun-09	Year Ended 30-Jun-08
	Audited	Audited and restated	Audited and restated
	\$	\$	\$
Net Sales	6,206,354	5,574,021	3,967,461
Earnings (loss) before interest and other income, taxes, depreciation and amortization ⁽¹⁾	(746,156)	(883,934)	(1,826,950)
Total income (loss) from continuing operations	(1,365,064)	(1,637,901)	(2,407,857)
Operating income (loss) per share	(0.04)	(0.06)	(0.12)
Net income (loss)	(1,365,064)	(1,637,901)	(2,407,857)
Basic and diluted earning (loss) per share	(0.04)	(0.06)	(0.10)
Total assets	8,184,462	9,185,273	9,439,091
Total long term financial liabilities	441,592	1,730,528	1,878,161
Cash dividends declared per share	Nil	Nil	Nil

(1) EBITDA represents earnings (losses) 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 (Generally Accepted Accounting Principles) earnings measure, therefore it does not have any standardized meaning prescribed by Canadian GAAP and may not be similar to measures presented by other companies.

ADOPTION OF NEW ACCOUNTING STANDARDS AND DEVELOPMENTS

(a) 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. The Company adopted this standard for its interim and annual financial statements for its fiscal year commencing July 1, 2009. The adoption of this standard did not have a material effect on the Company's financial statements.

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ADOPTION OF NEW ACCOUNTING STANDARDS AND DEVELOPMENTS (continued)

(b) CICA 3862, "Financial Instruments – Disclosures"

During the year, the CICA amended Section 3862 to enhance fair value and liquidity disclosures. The standard now requires that all financial instruments measured at fair value be categorized into one of three hierarchy levels. Each level is based on the transparency of inputs to the valuation of the financial asset or liability as of the measurement date. The adoption of this standard did not have a material effect on the consolidated financial statements. The disclosures required by this amendment are disclosed in Note 19.

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

During the year, the CICA amended Section 3855 to bring greater consistency between Canadian GAAP, IFRS and US GAAP regarding the timing of impairment recognition for debt instruments. The amendments allow more debt instruments to be classified as loans and receivables. In addition, the amendments require reversal of previously recognized impairment losses on available-for-sale financial assets in specified circumstances and require that loans and receivables that an entity intends to sell immediately or in the near term be classified as held for trading. The transitional provisions are complex and are accompanied by disclosure requirements to explain any reclassifications made on adopting the amendments.

RESTATEMENT OF PRIOR PERIOD FIGURES

During the year ended June 30, 2010, the Company determined that it was more appropriate to recognize amortization of property and equipment using the straight-line method as it better reflected the economic usage of the related assets. The Company previously recognized amortization on the declining balance basis. As a result of the change in accounting policy, the comparative financial statements for the year ended June 30, 2009 have been restated as follows:

	As Previously Reported	Change	As Restated
Statement of Operations:			
Amortization	\$ 1,104,178	\$ (539,388)	\$ 564,790
Net loss	2,177,289	(539,388)	1,637,901
Loss per share – basic and diluted	(0.08)	(0.02)	(0.06)
Deficit, beginning of year	5,821,374	(937,833)	4,883,541
Deficit, end of year	8,039,463	(1,477,221)	6,562,242
Balance Sheet:			
Property and equipment	2,568,720	1,477,221	4,045,941
Deficit	\$ 8,039,463	\$(1,477,221)	\$ 6,562,242

RECLASSIFICATIONS

Certain 2009 figures have been reclassified to conform to the financial statement presentation adopted for the year ended June 30, 2010.

RUSSELL BREWERIES INC.
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PERFORMANCE AND RESULTS OF OPERATIONS

The Three Months Ended June 30, 2010 (“Q4 2010F”)

Net Sales for Q4 2010F were \$1,600,802 up \$138,066 or 9.44% compared to \$1,462,736 for the three months ended June 30, 2009 (Q4 2009F). The net sales increase, which was achieved in a very competitive beer market and basically a flat economy, was a result of a number of initiatives implemented by management over the past twelve months. Those included the initial distribution of Russell Cactus Lime Lager and Russell Cream Ale into Alberta, introduction of and continuing improvement of distribution for the Company’s core brands in bottles, and more points of distribution for the Company’s new Rocky Mountain product line which competes in the premium discount sector.

The gross margin for Q4 2010F was down \$273,586 or 44.70% to \$338,417 compared to \$612,003 for Q4 2009F. Overall gross margin percentage decreased by 20.70% to 21.14% compared to the same period a year ago reflecting a higher production cost in packaged products. The decrease in gross margin is primarily a result of adjusting production cost for inventory in transit to be recognized in Q4.

Selling, general and administration expense for Q4 2010F increased \$145,749 or 18.60% to \$929,324 compared to \$783,575 for Q4 2009F. While the expenses were decreased in certain categories as a result of implementing an expense control system in Q1 2010F, the expense in marketing, promotion and labour increased significantly. The increase in expenses consist of marketing and promotion increase of \$170,126 to \$421,694 from \$251,568, administrative labor increase of \$53,042 to \$255,533 from \$202,491, an increase of \$15,599 in bank charges to \$30,330 from \$14,731, an increase of \$8,974 in repairs and maintenance to \$38,365 from \$29,391, and which is offset by management fees decrease of \$10,833 to \$26,302 from \$37,135, a decrease of \$49,386 in professional fees to \$60,310 from \$109,696, a decrease of \$44,633 in consulting fees to \$nil from \$44,633, a decrease of \$15,359 in travel expenses to \$10,984 from \$26,343, office expense decrease of \$2,715 to \$25,922 from \$28,637, and a decrease of \$2,195 in transfer agent and filing fees to \$3,235 from \$5,430.

Net loss increased \$323,382 or 97.89% to \$653,725 for Q4 2010F or \$0.02 per share compared to the net loss of \$330,343 or \$0.01 for Q4 2009F. Overall, the increase in net loss is the result of adjusting production cost for inventory in transit to be recognized in Q4.

The Year Ended June 30, 2010 (“2010F YTD”)

Net Sales for 2010F YTD were \$6,206,354 up \$632,333 or 11.34% compared to \$5,574,021 for the year ended June 30, 2009 (2009F YTD). The net sales increase, which was achieved in a very competitive beer market and basically a flat economy, was a result of a number of initiatives implemented by management over the past nine months. Those included the initial distribution of Russell Cactus Lime Lager and Russell Cream Ale into Alberta, introduction of and continuing improvement of distribution for the Company’s core brands in bottles, and more points of distribution for the Company’s new Rocky Mountain product line which competes in the premium discount sector.

The gross margin for 2010F YTD was up \$118,175 or 4.45% to \$2,773,525 compared to \$2,655,350 for 2009F YTD. Overall gross margin percentage decreased by 6.19% to 44.69% compared to the same period a year ago. The decrease in gross margin is primarily a result of adjusting production cost for inventory in transit to be recognized in Q4.

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PERFORMANCE AND RESULTS OF OPERATIONS (continued)

The Year Ended June 30, 2010 ("2010F YTD") (continued)

Selling, general and administration expense for 2010F YTD decreased \$19,603 or 0.55% to \$3,519,681 compared to \$3,539,284 for 2009F YTD. While the expenses were decreased in certain categories as a result of implementing an expense control system in Q1 2010F, the expense in marketing, promotion and labour increased significantly. The increase in expenses consist of marketing and promotion increase of \$215,629 to \$1,128,421 from \$912,792, an increase of \$26,338 in bank charges to \$81,492 from \$55,154, an increase of \$38,297 in rent and utilities to \$438,274 from \$399,977, which is offset by automotive decrease of \$15,532 to \$176,308 from \$191,840, consulting fees decrease of \$45,936 to \$1,557 from \$47,483, insurance decrease of \$1,386 to \$38,744 from \$40,130, investor relations decrease of \$2,903 to \$4,218 from \$7,121, office expense decrease of \$2,512 to \$110,012 from \$112,524, repairs and maintenance decrease of \$39,072 to \$95,354 from \$134,426, small-ware decrease of \$22,266 to \$13,101 from \$35,367, management fees decrease of \$141,903 to \$129,410 from \$271,313, professional fees decrease of \$36,667 to \$263,801 from \$300,468, telephone decrease of \$7,553 to \$80,615 from \$88,168, and travel expense decrease of \$21,083 to \$59,893 from \$80,976.

Net loss decreased \$272,837 or 16.66% to \$1,365,064 for 2010F YTD or \$0.04 per share compared to the net loss of \$1,637,901 or \$0.06 for 2009F YTD. The decrease in net loss were the result of sales increase as well as the cost reduction program and expense control system implemented in Q1 2010F.

Summary of Quarterly Results

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

Fiscal Year Quarter	2010F Q4	2010F Q3	2010F Q2	2010F Q1	2009F Q4	2009F Q3	2009F Q2	2009F Q1
	\$	\$	\$	\$	\$	\$	\$	\$
Net revenues	1,600,802	1,385,239	1,386,353	1,833,960	1,462,736	1,061,631	1,350,726	1,698,928
EBITDA ⁽¹⁾	(590,907)	(226,743)	(96,201)	167,695	(171,572)	(355,691)	(389,346)	32,675
Net loss (Restated)	(653,725)	(415,421)	(300,351)	4,433	(330,343)	(555,089)	(585,598)	(166,872)
Net loss per share (Restated)	(0.02)	(0.01)	(0.01)	0.00	(0.01)	(0.02)	(0.02)	(0.00)

(1) EBITDA represents earnings (losses) 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 GAAP and may not be similar to measures presented by other companies.

Q1 2010F to Q4 2009F net sales were up \$371,224 or 25.38% due to seasonality, distribution of Cactus Lime Lager in Alberta and continued improvements in retail distribution of Russell core brands in British Columbia. Q1 2010F to Q4 2009F net loss were down \$357,891 or 76.93% as a result of \$371,224 increase in net sales. The Company achieved all time record positive EBITDA of \$167,695 in Q1 2010F.

Q2 2010F to Q1 2010F net sales were down \$447,607 or 24.41% due to seasonality, which confirmed the normal trend of beer consumption. Q2 2010F to Q1 2010F net loss were up \$304,784 or 284.05% as a result of \$447,607 down in net sales. The seasonality has been absorbed by the previous quarter's record EBITDA and the Company successively maintained positive EBITDA of \$71,494 for 2010F YTD.

Q3 2010F to Q2 2010F net sales were down \$1,114 or 0.08% due to seasonality, which confirmed the normal trend of beer consumption. Q3 2010F to Q2 2010F net loss were up \$110,832 or 26.90% as a result of \$179,707 down in gross margin. The seasonality has been absorbed by the previous quarters' positive EBITDA.

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PERFORMANCE AND RESULTS OF OPERATIONS (continued)

Summary of Quarterly Results (continued)

Q4 2010F to Q3 2010F net sales were up \$215,563 or 15.556% due to seasonality, which confirmed the normal trend of beer consumption. Q4 2010F to Q3 2010F net loss were up \$238,304 or 57.36% as a result of \$278,729 down in gross margin. The seasonality has been absorbed by the previous quarters' positive EBITDA.

LIQUIDITY AND CAPITAL RESOURCES

Financial Condition

At June 30, 2010, the Company had net working capital deficit of \$1,489,753. The Company has \$200,000 of restricted cash securing \$100,000 of bank indebtedness and \$100,000 of capital leases. Long-term debt is \$1,713,959. Included in long-term debt and current portion of long-term debt is a three year secured shareholder loan to the Company entered into on December 31, 2007 for net proceeds of \$925,565.

The Company has neither a history of earnings nor has it paid any dividends. The management anticipates that the Company will be profitable in 2011F although there is no guarantee.

Funds on hand are low due to seasonality. The Company may need additional capital to fund its expected operating losses and planned non discretionary capital expenditures for the next twelve months. The Company is seeking 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

The Three Months Ended June 30, 2010 ("Q4 2010F")

Net cash provided in operating activities in Q4 2010F was \$69,975 compared to \$367,056 cash used in Q4 2009F, a decrease in use of \$297,081 primarily due to an increased use of \$222,001 in accounts payable and accrued liabilities, a decreased use of \$138,562 in inventories, a decreased use of \$169,614 in prepaid expense and a decreased use of \$227,333 in accounts receivable, which is offset by an increase of \$428,146 in net loss after adjustment for items not affecting cash.

Cash used in Q4 2010F for purchasing property and equipment decreased \$38,076 compared to Q4 2009F.

During Q4 2010F and 2009F, the Company received \$125,000 from a demand loan compared to \$772,863 from equity financing in Q4 2009F. The Company repaid \$97,487 of capital lease obligations, long-term debt and bank demand loans during Q4 2010F compared to \$65,90 repaid in Q4 2009F.

The Year Ended June 30, 2010 ("2010F YTD")

Net cash used in operating activities in 2010F YTD was \$277,497 compared to \$889,196 used in 2009F YTD, a decrease in use of \$611,699 primarily due to a decreased use of \$690,385 in accounts receivable, a decreased use of \$145,492 in prepaid expense, and a decrease of \$178,289 in net loss after adjustment for items not affecting cash which was offset by an increased use of \$46,198 in inventories, an increased use of \$333,420 in accounts payable and accrued liabilities.

Cash used in 2010F YTD for purchasing property and equipment decreased \$47,840 to \$41,896 compared to \$89,736 used in 2009F YTD.

During 2010F YTD, the Company received \$136,534 from a demand loan compared to \$772,862 from equity financing in 2009F. The Company repaid \$387,055 of capital lease obligations, long-term debt and bank demand loans during 2010F YTD compared to \$293,172 repaid in 2009F YTD.

LIQUIDITY AND CAPITAL RESOURCES

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The Year Ended June 30, 2010 (“2010F YTD”)(continued)

A total of \$nil of capital assets were purchased under capital lease obligations compared to \$22,933 in 2009F YTD. These acquisitions did not result in an immediate outlay of cash.

Financing

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.

On December 31, 2007, the Company entered into a shareholder loan 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.

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 of \$787,500 is to be repaid by 42 consecutive monthly principal installments of \$18,750 each commencing June 15, 2009. The maturity date is November 15, 2012. The bank also granted a reduction of the interest variance on the term loan by 1%. With the exception of the amendments agreed, all terms and conditions of the term loan remain unchanged.

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,

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LIQUIDITY AND CAPITAL RESOURCES (continued)

Financing (continued)

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.

On July 5, 2010, the Company received an advance of \$250,000 from a partner of the primary lender of the demand loan described in Note 9. This advance is subject to terms and conditions of the loan facility agreement entered into on June 17, 2010 and accordingly, bears interest at the lesser of 2% of the average loan balance during the month and 2% of the proceeds advanced under the agreement. The loan is repayable on demand and is secured by a general security agreement of the assets of the Company and by specific assignment of a joint signing account.

On September 22, 2010, the bank made an amendment to the existing term loan described in note 10(a) in accordance with the request of the Company. Pursuant to the amendment, the remaining loan amount is to be repaid in 50 consecutive monthly installments of \$9,750 each commencing October 15, 2010 and ending November 15, 2014.

On July 5, 2010, the Company received an advance of \$250,000 from a partner of the primary lender of the demand loan described in Note 9. This advance is subject to terms and conditions of the loan facility agreement entered into on June 17, 2010 and accordingly, bears interest at the lesser of 2% of the average loan balance during the month and 2% of the proceeds advanced under the agreement. The loan is repayable on demand and is secured by a general security agreement of the assets of the Company and by specific assignment of a joint signing account.

On September 22, 2010, the bank made an amendment to the existing term loan in accordance with the request of the Company. Pursuant to the amendment, the remaining loan amount is to be repaid in 50 consecutive monthly installments of \$9,750 each commencing October 15, 2010 and ending November 15, 2014.

On October 5, 2010, the Company announced a non-brokered private placement of an aggregate of \$1,000,000 principal amount of convertible debentures (the "Convertible Debentures") and a non-brokered private placement of units (the "Units") at a price of \$0.08 per Unit for additional proceeds of up to \$1,000,000. The Convertible Debentures will mature on the date that is two years from the date of issuance and bear interest at 10% per annum, payable quarterly. The principal amount of the Convertible Debentures is convertible into common shares of the Company, at any time from the date of issuance until the maturity date, at a price equal to \$0.15 per common share. Each Unit will consist of one common share and one share purchase warrant (a "Warrant"), each Warrant entitling the holder to purchase one additional common share at a price of \$0.15 per common share for a period of two years from the date of issuance.

On October 25, 2010, the Company announced that the non-brokered private placements described above would now be conducted as brokered private placements and that the aggregate amount of up to \$2,000,000 will be raised from the sale of the Convertible Debentures and the Units, in any combination thereof. A commission of 10% of the total gross proceeds realized from the Offerings is payable in cash together with that number of agent's warrants (the "Agent's Warrants") as is equal to 12% of the number of Units and 12% of the number of common shares underlying the Convertible Debentures sold pursuant to the Offerings. Each Agent's Warrant entitles the holder, on exercise, to purchase one unit on the same terms as the Units, at a price of \$0.08 per unit. The Agent will also receive a corporate finance fee of 625,000 common shares.

As at October 28, 2010, the Company had received \$nil proceeds relating to this financing as amounts received under subscription agreements were being held in trust subject to certain closing conditions. There is no guarantee that this financing will close subsequent to the issuance of these financial statements.

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RELATED PARTIES

The Company's Board of Directors consists of Brian Harris, CEO, Andrew Harris, President and Chief Financial Officer, John Morgan, Chairman, Richard Shier and Paul Robertson.

During the year ended June 30, 2010, the Company incurred salaries and wages expense of \$156,018 to relatives of directors of the Company (2009 – \$63,669) and salaries of \$48,000 to a director of the Company (2009 – \$63,000 in consulting fees). 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.

As at June 30, 2010, the Company is owed \$45,392 (2009 – \$42,375) from two officers and a director of the Company. The amounts are non-interest bearing, unsecured and due on demand.

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 straight line 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. The Company did not grant options during the year ended June 30, 2010 and 2009.

On October 18, 2010, the Company granted 100,000 stock options pursuant to its stock option plan, exercisable for up to five years at a price of \$0.10 per share.

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OUTSTANDING SHARE DATA

The Authorized share capital consists of unlimited common shares without par value.

Outstanding Share Data	Number of Common Shares	Exercise Price per Common Share	Expiry Dates
Issued and outstanding as at October 28, 2010	33,325,437	N/A	N/A
Stock Options	2,345,000	\$0.08 - \$0.55	April 13, 2011 – October 18, 2015
Conversion of preferred shares ⁽¹⁾	1,133,560	\$0.60	March 31, 2013
Warrants ⁽²⁾	<u>6,665,087</u>	\$0.25	June 8, 2011
Fully Diluted as at October 28, 2010	<u>43,469,084</u>	N/A	N/A

(1) After five years (the "Exchange Date") the 68,000 preferred shares 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 RBC. At the Exchange Date, the exchange ratio will be increased for any penalty incurred or for any unpaid dividends.

(2) 6,665,087 warrants were fully vested on June 9, 2010.

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 and Manitoba Liquor Control Commission, 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.

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RISKS AND UNCERTAINTIES (continued)

Disclosure Controls and Procedures

Management has designed disclosure controls and procedures and internal controls and procedures over 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 financing reporting during the period ended June 30, 2010.

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.
- 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.

ADDITIONAL INFORMATION

For additional information relating to Russell Breweries Inc. please review SEDAR website at www.sedar.com and the Company's website at www.russellbeer.com or to contact Brian Harris, Russell Breweries Inc., 13018 80th Avenue, Surrey, BC V3W 3B2 ,Telephone: (604) 599-1190 Facsimile: (604) 599-1048.