

### Compliance Energy Corporation (TSXV: CEC) – Summer Infill Drill Program Complete

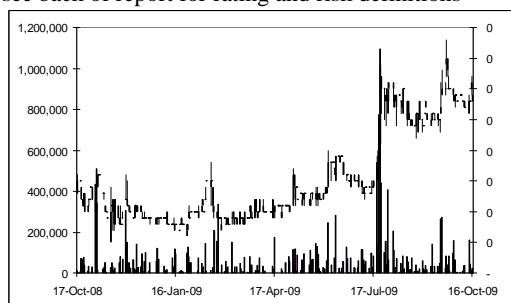
Sector/Industry: Junior Mining

[www.complianceenergy.com](http://www.complianceenergy.com)

#### Market Data (as of October 19, 2009)

Current Price	C\$0.30
Fair Value	C\$1.30
Rating*	BUY
Risk*	5 (Highly Spec)
52 Week Range	\$0.05 - \$0.38
Shares O/S	47.45 mm
Market Cap	\$14.23 mm
Current Yield	N/A
P/E (forward)	N/A
P/B	0.90
YoY Return	100.0%
YTD TSXV	41.5%

\*see back of report for rating and risk definitions



#### Investment Highlights

- The summer infill drill program on the Raven Underground Coal Project has concluded. 42 holes were completed for a total of 9,899 meters.
- We anticipate the program will upgrade a significant portion of the 59 million tonnes of inferred resource to measured and indicated so they may be applied in the ongoing feasibility study. At this time, measured and indicated resources stand at 39 million tonnes.
- Coal quality tests are underway to determine the project's viability as a metallurgical coal source.
- The company has received a section 10 order from the British Columbia Environmental Assessment office prompting the environmental review process required for production.
- During our site visit in late July 2009, we observed the many positive aspects of both proximal and on-site infrastructure that are contributing to the development of the project.
- CEC shares are up 131% since we initiated coverage in June 2009. However, even at current prices, we believe that the market not only does not assign any value to any of the company's projects, but also does not fully value the company's liquid assets including working capital, Copper Mountain and Jameson Resource (JAL) shares, and future option payments from JAL.
- We have maintained our BUY rating, and fair value estimate at \$1.30.

#### Key Financial Data (FYE - December 31)

(C \$)	2007	2008	2009 (6 mo)
Cash + Marketable Securities	666,090	2,134,373	6,628,745
Working Capital	41,645	1,517,474	6,017,535
Mineral Assets	8,498,245	10,168,987	9,519,280
Total Assets	10,023,774	12,935,926	16,880,960
Long Term Debt	280,000	2,110,000	280,000
Net Profits	1,363,307	345,918	5,117,020
EPS	0.03	0.01	0.11

**Note:** An FRC analyst has visited the Raven Underground Coal Project in the past 12 months

*Compliance Energy is currently developing the Raven Coal Project on Vancouver Island, British Columbia. The project has resources of 39 million tonnes measured and indicated, and 59 million tonnes inferred. The company recently signed a joint venture to aid in project development.*

***Raven  
Underground  
Coal Project***

**Infill Drill Program**

Compliance recently completed a summer infill drilling program on the Raven Underground Coal Project. The program is summarized as follows:

- 42 drill holes
- 9,899 meters drilled
- Infill drilling to upgrade inferred resources to indicated or measured for application in the ongoing feasibility study
- Core samples sent for coal quality analysis and washability testing

The company reports that intersections of Seam 1 ranged from 1.0 meter to 7.4 meters while intersections of Seam 3 ranged from 0.65 meters to 5.35 meters. (Note: These are drill intersected thicknesses). The results appear to be consistent with information gathered from previous exploration as well as what was anticipated. Seam 1 is believed to average between 2.5 and 3.0 meters in thickness while Seam 3 achieves (or is greater than) the minimum mining width of 1.5 meters in approximately 60% of the holes drilled in 2009. Actual thicknesses encountered in past exploration also showed significant variability in intersected widths.

***Our Interpretation***

Results appear to be as anticipated and we believe that a significant portion of inferred resources will be upgraded to at least the indicated level of confidence. We expect overall resources will remain around the 100 million tonne mark (i.e. similar to the total of inferred plus indicated resources).

**We feel that the most important part of the program was the building of a significant sample base by which both Seams 1 and 3 can be tested for their viability as sources of metallurgical coal.** Birtley Coal & Minerals Testing Division of GWIL Industries in Calgary, Alberta, has been commissioned to perform the coal quality analysis and washability testing.

**Feasibility Study**

Pincock, Allen & Holt are completing a feasibility study on the Raven Underground Coal Project which is scheduled to be completed in the 2<sup>nd</sup> quarter of 2010. The summer drill program was designed to upgrade all NI 43-101 resources to the status of measured or indicated for the purpose of applying them in the feasibility study.

**Environmental Review**

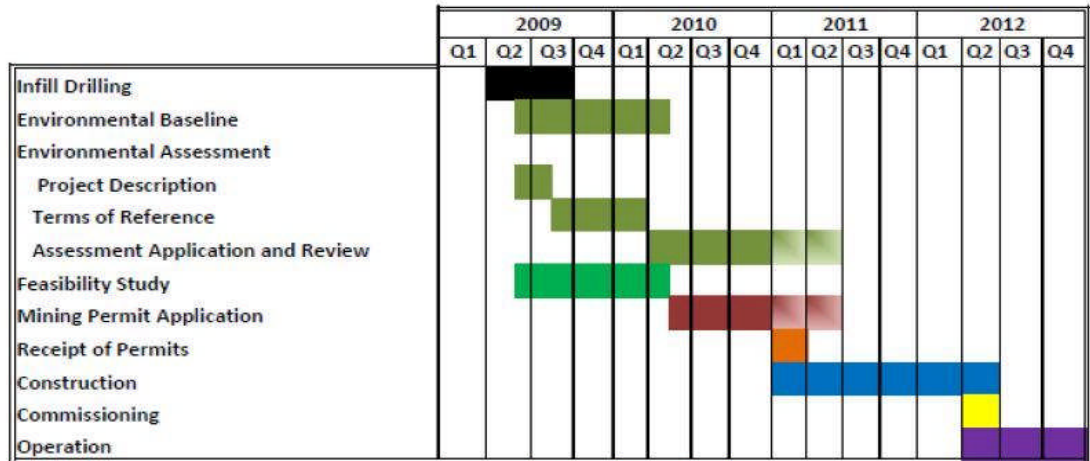
The company has been issued a Section 10 order from the British Columbia Environmental Assessment Office. **A Section 10 order is positive feedback from the Assessment Office as it triggers the environmental review process required for projects heading towards production.** The company has commissioned AMEC Earth and Environmental to prepare the environmental assessment for the project.

**Development Timeline**

The company is maintaining the development timeline previously laid out giving us further

confidence, particularly in management. The timeline is presented below.

## Raven Project Next Steps 2009/2010



Source: Compliance Energy Corp.



Figure 1: FRC Research Associate Vincent Weber on-site during Raven Underground Coal Project drilling (Source: Fundamental Research Corp.)



*Figure 2: Compliance Energy Corp. President and CEO John Tapics P.Eng in front of Seam #1 at the Raven test adit. (Source: Fundamental Research Corp.)*



*Figure 3: Historic and active logging provided access infrastructure and space for future milling construction. (Source: Fundamental Research Corp.)*

### **Jameson Resources – Basin Coal Project**

Jameson Resources Ltd. (ASX: JAL), who holds an option to acquire Compliance's 100% interest in the Basin Coal Mine, continues to advance the project towards restarting production. In late July 2009, JAL announced an updated technical report on the project which included an increased resource base.

We feel JAL's earnest approach to advancing the project is valuable as Compliance still stands to receive a further option payment of \$3.1 million and 7.41 million JAL shares on or before May 31, 2010. The company will also receive a final option payment of 7.41 million JAL shares upon the earlier of the commencement of production or May 31, 2012.

### **Copper Mountain**

As previously noted, the company holds 2.31 million shares in Copper Mountain Mining Corporation (TSX: CUM). In the midst of working out a \$50 million financing at \$1.15 per share, CUM was offered, and subsequently rejected, an unsolicited financing offer from Taseko Mines Ltd. (TSX: TKO) of \$10 million at \$2.20 per share. The CUM board felt the offer was not in the best interest of shareholders as they felt the transaction would significantly delay the progress of the project and did not account for CUM's growth potential.

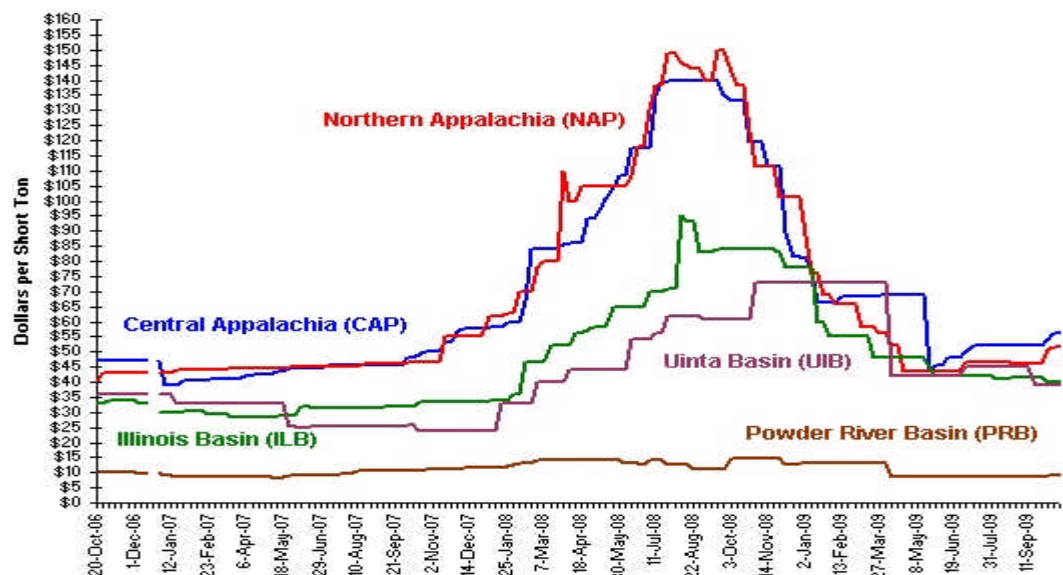
The value of the company's CUM holdings has increased 158% since our initiating report.

### **Outlook on Coal**

Recently, the coal market has seen some very positive developments from China - the world's largest consumer and producer of coal.

- **Chinese coal imports up significantly YOY:** The significant drop in coal prices after the huge run in 2008 (see chart below), coupled with the economic recovery in China, has resulted in a significant increase in Chinese coal imports since the beginning of this year. In the first half of 2009, China's coal imports were 48.25 million tons, up 124% YOY.

**Historical Average Weekly Coal Commodity Spot Prices  
(4 per Short Ton) Business Week Ended October 16, 2009**



Source: Energy Information Association

- In the first half of 2009, Chinese **coal exports dropped by 54% YOY**.
- China has **started reopening small mines** to meet increasing domestic demand.
- Economic recovery in China, along with its US\$586 billion stimulus package, has led to a **stronger than expected recovery in Chinese steel production**. According to the World Steel Association, although total steel production (based on the 66 countries reporting to the WSA) dropped by 18% YOY in the first eight months of 2009, Chinese production increased by 5.2% YOY (22% YOY in August 2009). Production in India was also up by 1.5% YOY during the same period.

All the above, we believe, are indications that coal prices will stay strong in the near-term. We have maintained our long-term forecasts (2012+) of \$67.5/tonne for thermal coal, and \$110/tonne for metallurgical coal, as there has been no significant change in the long-term supply and demand fundamentals since our initiating report in June 2009.

### **Financials**

CEC had cash (including marketable securities) and working capital of \$6.63 million and \$6.02 million, respectively, at the end of Q2-2009 (quarter ended June 2009). Note that cash and working capital at the end of June also include CEC's share (of \$4.2 million) of cash received from the formation of the Comox Joint Venture. The table below shows the company's cash position and liquidity ratios.

(C\$)	2007	2008	2009 (6 mo)
Working Capital	41,645	1,517,474	6,017,535
Current Ratio	1.1	3.3	8.9
LT Debt / Assets	2.79%	16.31%	1.66%
Cash From Financing Activities	(3,603,519)	1,630,000	2,931,813
Monthly Burn Rate (including exploration)	(195,159)	(141,764)	(123,964)

CEC continues to be in good cash position, and we do not foresee any need for external financings in the next 12 months.

**Stock Options & Warrants:** At the end of June 2009, the company had 4.61 million options outstanding with an exercise price of \$0.11, and a weighted average time to maturity of 3.43 years (all options are currently in the money). The company does not have any warrants outstanding.

### **Valuation**

As we continue to believe it is highly likely that CEC will be able to convert most of its inferred resource to the measured and indicated category, we have continued to discount the inferred resource by only 25% (instead of the 50% discount we usually apply to inferred resources in our valuation models). We have continued to use 100% of measured and indicated resources.

Our estimate of the number of diluted shares (calculated based on the treasury stock method) increased from 47.57 million to 50.36 million due to the increase in CEC's share price in the past few months, and as the company re-priced its outstanding options to \$0.11 per share. Our revised valuation dropped from \$1.28 to \$1.17 per share primarily because of this

increase in the number of diluted shares outstanding, offset by a 63% increase in JAL, and a 158% increase in CUM share prices. We did not make any other noteworthy changes in our valuation models. A summary of our revised valuation follows.

Valuation Summary	Valuation (\$/share)
<b>Raven and Bear Projects</b>	
Average (DCF, Real Options & Comparables)	\$0.72
Working Capital - Debt	\$0.07
Estd. option payments (cash + shares) from JAL, and the market values of CUM and JAL shares currently held	\$0.34
Book Value of Other Projects	\$0.05
<b>Fair Value</b>	<b>\$1.17</b>

*Note: We have continued to value the Raven coal project based on production of metallurgical coal (the scenario which has a higher net asset value estimate – please see our initiating report on the company for net asset value comparisons between metallurgical and thermal coal).*

### **Conclusions & Rating**

CEC shares are up 131% since we initiated coverage in June 2009. However, even at current prices, we believe that the market not only does not assign any value to any of the company's projects, but also does not fully value the company's liquid assets (valued at \$0.41 per share), which includes working capital, CUM and JAL shares, and future option payments from JAL.

Based on our revised valuation models, we reiterate our BUY rating, and maintain our fair value estimate at \$1.30 per share as results since our initial report have been meeting expectations.

### **Risks**

The following risks, though not exhaustive, may cause our estimates to differ from actual results:

- The value of the company is dependant on coal prices.
- Several different entities have explored these properties in the past with no further action.
- The success of drilling, project development and resource expansion are important long term success factors for the company.
- Access to capital and share dilution.

**We rate the company's shares a RISK of 5 (Highly Speculative)**

**Fundamental Research Corp. Equity Rating Scale:**

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

**Hold** – Annual expected rate of return is between 5% and 12%

**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

**Suspended or Rating N/A**— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

**Fundamental Research Corp. Risk Rating Scale:**

**1 (Low Risk)** - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk)** - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

**3 (Average Risk)** - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative)** - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative)** - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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