

Sonic Technology Solutions Inc. (TSXV: SNV) – Significant progress in the energy sector; Plans to acquire process chemistry

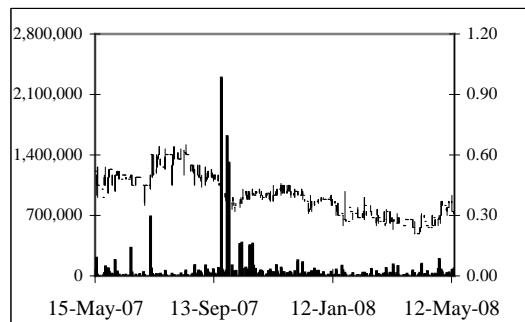
Sector/Industry: Energy/Sonic

www.sonictsi.com

Market Data (as of May 15, 2008)

Current Price	C\$0.34
Fair Value	C\$1.39 (↑)
Rating*	BUY
Risk*	4 (Speculative)
52 Week Range	C\$0.21 – C\$0.65
Shares O/S	41,324,068
Market Cap	C\$14.05 mm
Current Yield	N/A
P/E (forward)	N/A
P/B	1.76
YoY Return	-32.0%
YoY TSXV	-20.6%

*see back of report for rating and risk definitions



FY2007 Highlights

- On April 28, 2008, the company announced that they plan to acquire all of the issued and outstanding shares of Northern Oil Research Technologies Inc. NORT is an Alberta based oil process development company, that has developed and patented a low pressure and temperature chemical process, which can increase the API of heavy oil from 10 to over 28, and reduce sulphur content and CO₂ production. By integrating Sonic's Sonoprocess™ technology with NORT's chemical processes, we believe, producers can receive more value for their produced oil (approx 22% increase in value based on prices in W Canada in the first four months of 2008) and reduce transportation costs.
- On April 30, 2008, Sonic announced that they intend to acquire the remaining issued and outstanding shares of PetroSonic Energy Systems Inc., and increase ownership from 40% to 100% by issuing 3 million common shares.
- With the acquisition of PetroSonic and NORT, we believe, Sonic will be well positioned to advance development and installation of a successful pilot plant and commercial implementation. Sonic will have 100% ownership in this venture.
- The next 12 months is an exciting period for the company and their partners as they confirm the viability of the Sonoprocess™ technology in the energy and materials sectors, and progress their projects to commercialization.
- Sonic will issue 5 million shares if the two recently proposed acquisitions are completed.

Financial Summary (YE Dec 31)

(C\$)	2005	2006	2007	2008E	2009E
Revenue	1,114,439	1,665,706	1,102,539	578,833	1,366,716
Gross Margin	-72.70%	-110.07%	-58.53%	-25.00%	-10.00%
Net Income	(6,206,445)	(7,299,328)	(4,728,192)	(3,695,154)	(4,038,702)
EPS (basic)	(0.41)	(0.32)	(0.12)	(0.09)	(0.10)
Cash	1,947,802	1,751,908	1,247,210	172,604	278,597
Assets	11,002,491	10,774,605	9,220,047	8,273,121	10,581,796
Debt to Capital*	11.13%	0.00%	0.48%	2.14%	2.74%
ROE	-91%	-58%	-46%	-52%	-37%
ROIC	-81%	-58%	-46%	-51%	-36%

* Includes only lease obligations

Sonic Technology Solutions Inc., based in Vancouver, Canada, has a patented technology to generate industrial-scale sonic energy. Sonic's patented Sonoprocess™ technology is the world's first and only industrial-scale sonic generator technology. After successfully commercializing its technology in the environmental sector, the company is now actively trying to commercialize the technology's application in the energy (heavy oil and oil sands) sector and the materials sectors.

Announced plans to acquire process chemistry

On April 28, 2008, Sonic announced that it intends to acquire all of the issued and outstanding shares of Northern Oil Research Technologies Inc. (NORT), an Alberta based oil process development company. Sonic will pay up to \$3 million in an all-share-deal (contingent on the achievement of key milestones), with an initial price of \$0.5 million (2 million shares at \$0.25 per share will be issued) upon the acquisition of NORT shares. The transaction is expected to be completed in 45 days.

Over the last three years, NORT has developed and patented a cold – cracking (low pressure and temperature) chemical process for upgrading heavy crude oil or bitumen. NORT's chemical process has demonstrated increases in the API of heavy oil from 10 (extra heavy oil/bitumen) to over 28 (heavy-medium oil), in addition to significant reductions in sulphur content, and CO₂ production, while maintaining a high liquid yield. The Alberta Research Council (ARC) has confirmed the performance of NORT's chemical process. NORT's Chief Scientist, Mr. Frederick Boakye, will join Sonic.

Significance to Sonic: Heavy oil, being heavier and more viscous than conventional crude oil, has to be upgraded to reduce viscosity (de-asphalting / vis-breaking) to allow shipment by pipeline, and to improve quality by reducing sulphur content.

Sonic's Sonoprocess™ technology, by using high-intensity sonic energy, has the potential to improve the existing heavy oil refining processes by reducing viscosity and sulphur content. Sonic has already completed a successful demonstration of their proprietary accelerated upgrading Sonoprocess™ for heavy oil by de-asphalting and vis-breaking. Through the acquisition of NORT's process chemistry, we believe, Sonic will be equipped with an efficient heavy oil refining process that the Sonoprocess™ technology can be integrated with.

Extra heavy oil trades at a significant discount to light crude oil and medium oil. For example, Canada Heavy Hardisty (12 API) traded at an average price of \$75.23/bbl in the first four months of 2008, versus the average price of Cromer Medium (29.3 API) of \$92.11/bbl, a discount of 18%. As mentioned earlier, NORT's chemical process has the capability of increasing the API of heavy oil from 10 to 28. If Sonic's Sonoprocess™ technology is integrated with NORT's chemical processes, we believe, producers can receive more value for produced oil (about 22% increase in value based on prices in W Canada in the first four months of 2008) and reduce transportation costs. In addition, Sonic believes they can help cut CO₂ production in the heavy oil refining process by utilizing agriculturally produced chemicals.

Project Economics: Sonic's management believes that, if implemented, the Sonoprocess™ technology can help producers improve netback by \$3/bbl - \$14/bbl. Assuming that Sonic receives tolling fees of at least \$3/bbl from producers in exchange for processing heavy oil, we estimate, the company can generate annual revenues of about \$2.19 million from a plant producing at 2,000 bpd.

Our estimate of global heavy oil production that Sonic can target is estimated at about 2.2 billion barrels per year. Therefore, a 1% market share in this space for PetroSonic

would imply annual revenues of \$65.70 million.

Plans to increase ownership in PetroSonic from 40% to 100%

The company made another significant announcement in April 2008. On April 30, 2008, Sonic announced that they intend to acquire the remaining issued and outstanding shares of PetroSonic Energy Systems Inc., and increase ownership from 40% to 100%.

PetroSonic is a private company focused on heavy oil production and processing, and has worked with heavy oil companies that were acquired by companies such as Ivanhoe Energy (TSX: IE), Pearl Exploration and Production Ltd. (TSXV: PXX) and MegaWest Energy Corp. (OTC: MGWSF). Sonic and PetroSonic Energy had entered into an agreement in May 2007 to develop a new heavy oil Sonoprocess™ for upgrading and processing heavy oil. Their partnership resulted in a successful demonstration of a proprietary accelerated upgrading Sonoprocess™ for heavy oil by de-asphalting and vis-breaking. PetroSonic funded the initial development of the process. Sonic currently holds a 40% equity interest in PetroSonic, in return for the grant of an exclusive licence. According to the recent announcement, Sonic will acquire the remaining 60% of the issued and outstanding shares of PetroSonic for an aggregate price of \$0.75 million by issuing 3 million common shares at \$0.25 per share.

With the acquisition of PetroSonic and NORT, we believe Sonic is well positioned to advance development and installation of a successful pilot plant and commercial implementation. Also, Sonic will have 100% ownership in this project.

In addition to this project, Sonic is also actively focusing on using sonic energy to enhance recovery of oil sands (through a partnership with Shell Canada: LSE: RDSA) and process fly ash for use as a substitute to cement. The next 12 months promises to be an exciting period for the company and their partners as they confirm the viability of the Sonoprocess™ technology in the energy and materials sectors, and progress their projects to commercialization.

Review of Q4-2007 results

The company generated most of its revenues in FY2007 from the first three commercial contracts for the environmental applications. In Q4-2007, the company recorded revenues of \$0.05 million versus \$0.49 million in Q4-2006. For the 12-month period ended December 2007, the company posted \$1.10 million (our forecast was \$1.49 million) versus \$1.67 million in FY2006. Revenues dropped YOY as the company had received a major project in FY2006, and as the company licensed out their Sonic Treatment System for operations in Canada to Quantum Murray LP in late 2007 (Sonic will receive 50% of the net proceeds from Quantum Murray's deployment of the technology).

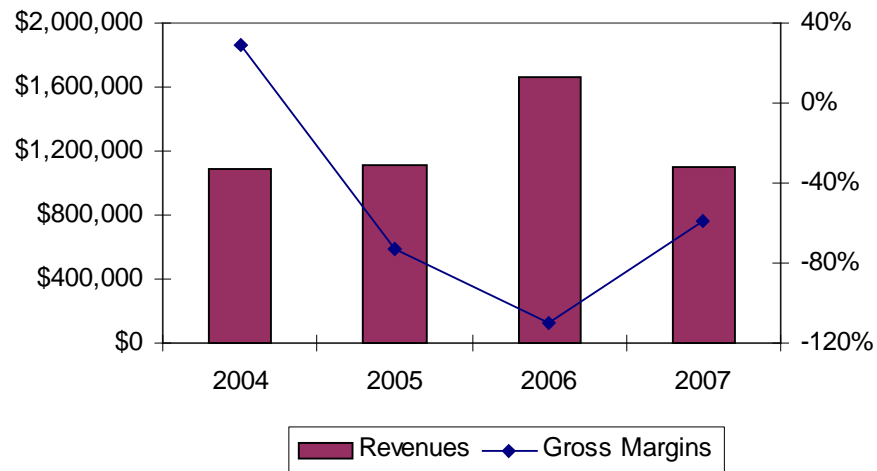
We expect revenues from this sector to moderate in FY2008, and pick up in FY2009, as the company's licensing partners penetrate deeper into their respective markets. We have lowered our revenue forecast for FY2008, and FY2009, from \$1.49 million, and \$1.64 million, respectively, to \$0.58 million, and \$1.37 million, respectively. Investors should note that current revenues do not reflect the true potential of the company, as the company's upside potential is expected to come from the successful implementation of

the Sonoprocess™ technology in other sectors, primarily the energy and materials sectors.

Margins

Sonic's revenues and gross margins are yet to stabilize as they are transitioning from a development company to commercialization. The chart below shows the company's revenues and gross margins since FY2004.

Revenues and Gross Margins



Margins have been highly volatile in the past as the company's revenue and costs have not stabilized yet. During FY2004 – 07, gross margins have ranged between –110% and 29%, and EBITDA margins have ranged between –401% to –215%. The table below shows margins since FY2004.

Margins	2005	2006	2007	2008E	2009E
Gross	-73%	-110%	-59%	-25%	-10%
EBITDA	-401%	-339%	-341%	-465%	-225%
EBIT	-444%	-408%	-437%	-649%	-296%
EBT	-557%	-438%	-429%	-638%	-296%
Net Margin	-557%	-438%	-429%	-638%	-296%

The sum of cost of goods sold (COGS) and general and administrative (G&A) expenses were \$4.46 million in FY2007, versus \$6.81 million in FY2006. Considering that our forecast for FY2007 was \$4.78 million, we were pleased to see the drop in costs. We have reduced our forecasts for G&A expenses in FY2008 and FY2009.

Net Loss: The company posted a net loss of \$4.73 million (EPS: -\$0.12) in FY2007 versus \$7.30 million (EPS: -\$0.32) in FY2006. Our estimate for FY2007 was a net loss of \$4.69 million (EPS: -\$0.11).

The drop in our costs forecasts more than offset the drop in our revenue forecasts, and as a result we have raised our EPS forecasts for FY2008, and FY2009, to net losses of \$3.70 million; EPS: -\$0.09 (up from \$4.18 million; EPS: -\$0.10) and \$4.04 million; EPS: -\$0.10 (up from \$4.30 million; EPS: -\$0.10), respectively.

Cash Flows

The company spent \$3.97 million on operations (including working capital) in FY2007 versus \$4.95 million in FY2006. As for investing activities, the company spent \$0.52 million in FY2007 on property, plant and equipment and patent maintenance, versus \$0.77 million in FY2006. Operating and investing activities were primarily funded by equity financing (\$3.99 million) in FY2007. We believe, Sonic will have to raise \$3.20 million to fund its operating and investing activities in FY2008.

Announced \$1.75 million financing: On May 12, 2008, Sonic announced their plans to pursue a brokered private placement to raise up to \$1.25 million. Sonic also intends to complete a non-brokered private placement to raise up to \$0.50 million. Sonic will issue up to 5.83 million units at a unit price of \$0.30. Each unit will consist of one common share and one-half of one common share purchase warrant (exercise price of \$0.45 per share; maturity period - 12 months). Sonic's share price has risen by 44% (from \$0.25 per share to \$0.36 per share) since our initiating report in March 2008. Therefore, we believe, it is good timing for the company to pursue a financing.

Cash and Liquidity Position

At the end of FY2007, the company had cash and working capital of \$1.25 million and \$1.55 million, respectively, versus \$1.75 million and \$0.81 million at the end of FY2006. The table below shows the company's liquidity, profitability and activity ratios.

Liquidity Analysis	2005	2006	2007	2008E	2009E
Working Capital	\$1,234,442	\$808,208	1,549,560	311,245	327,403
Current Ratio	1.64	1.32	2.51	1.81	1.55
Debt /Equity	12.5%	0.0%	0.5%	2.2%	2.8%
Debt/Capital	11.1%	0.0%	0.5%	2.1%	2.7%
Profitability Analysis	2005	2006	2007	2008E	2009E
Return on Avg Assets	-66.3%	-43.9%	-37.0%	-46.2%	-33.8%
Return on Avg Equity	-90.8%	-57.8%	-45.7%	-51.8%	-36.8%
Return on Average Invested Capital	-80.7%	-57.8%	-45.5%	-51.1%	-35.9%
Activity Analysis	2005	2006	2007	2008E	2009E
Days Inventory Outstanding	26	54	163	37	37
Days Accounts Receivable	28	236	526	219	110
Days Accounts Payable	133	468	510	183	110
Cash Conversion Cycle	(79)	(178)	179	73	37

Sonic is yet to achieve profitability; therefore all profitability ratios were negative in the past. Debt to Capital was 0.5% at the end of FY2007. Debt includes only capital lease obligations. Sonic will issue 5 million shares if the two recently proposed acquisitions are completed.

Stock Options and Warrants

At the end of 2007, the company had 5.62 million stock options outstanding (all of them are currently 'out-of-the-money') with a weighted average exercise price of \$1.05 per share, and maturity dates between September 2008 and December 2012.

The company also had 14.60 million warrants outstanding (all of them are currently 'out-of-the-money') with a weighted average exercise price of \$0.76 per share and maturity dates between March 2008 and April 2009.

Valuation

Our revised valuation on the company increased slightly from \$1.37 per share to \$1.39 per share due to the changes mentioned earlier in this report. Valuation increased as we raised the company's interest in the heavy oil upgrade project offset by share dilution. A summary of our revised base-case DCF valuation and scenario analysis is shown below.

DCF Valuation Model (in C\$)					
	2008E	2009E	2010E	2011E	2012E
FFO	(\$2,399,759)	(\$2,522,486)	(\$1,207,350)	(\$443,836)	\$1,632,805
Investment in WC	\$158,900	(\$32,965)	\$55,980	(\$334,731)	(\$461,185)
CFO	(\$2,240,859)	(\$2,555,451)	(\$1,151,370)	(\$778,567)	\$1,171,619
CAPEX	(\$2,000,000)	(\$3,050,000)	(\$3,050,000)	(\$5,050,000)	(\$5,050,000)
FCF	(\$4,240,859)	(\$5,605,451)	(\$4,201,370)	(\$5,828,567)	(\$3,878,381)
PV	(\$3,835,855)	(\$4,435,031)	(\$2,907,735)	(\$3,528,608)	(\$2,053,856)
	2013E	2014E	2015E	Terminal	
FFO	\$6,702,613	\$13,304,302	\$26,411,095	\$35,749,593	
Investment in WC	(\$497,148)	(\$1,312,386)	(\$585,812)	(\$1,575,771)	
CFO	\$6,205,465	\$11,991,916	\$25,825,283	\$34,173,823	
CAPEX	(\$5,050,000)	(\$5,050,000)	(\$5,050,000)	(\$5,050,000)	
FCF	\$1,155,465	\$6,941,916	\$20,775,283	\$29,123,823	
PV	\$535,247	\$2,812,901	\$7,363,762	\$91,191,588	
Discount Rate	14.32%				
Terminal Growth Rate	3%				
Total PV	\$85,142,412				
Cash - Debt	\$1,908,791				
Equity Value (C\$)	\$87,051,203				
Shares O/S (dil)	56,646,649				
Value per share	\$1.54				

Scenario Analysis (\$/share)			
1 application	(1)	Environmental applications	\$0.20
2 applications	(2)	Environmental and Heavy Oil Upgrade (1% market share)	\$0.87
	(3)	Environmental and Fly Ash (1% market share)	\$1.13
	(4)	Environmental and Heavy Oil Upgrade (2% market share)	\$1.35
	(5)	Environmental and Fly Ash (2% market share)	\$1.87
3 applications	(6)	Environmental, Heavy Oil Upgrade(1% market share) and Fly Ash (1% market share)	\$1.54
	(7)	Environmental, Heavy Oil Upgrade(2% market share) and Fly Ash (2% market share)	\$2.75
Probability weighted average			\$1.39

Rating

Based on our revised valuation models and review of the company's progress since our initiating report, we reiterate our BUY rating on Sonic, and slightly raise our fair value estimate on the company from \$1.37 per share to \$1.39 per share.

Risks

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

- The company's growth will depend heavily on its ability to commercialize the application of Sonoprocess™ technology in different sectors.
- Further penetration in the environmental sector will depend on its ability to license its technology.

- Failure to prove the viability of the Sonoprocess™ technology in the energy sector will put downward pressure on our valuation.
- We believe, the company has to raise approximately \$3.20 million in FY2008. Our valuation models assume that the equity financing will take place at current share prices. If share prices drop from current prices, it would negatively impact our valuation due to share dilution.

We rate the shares Risk 4 (Speculative).

Appendix

STATEMENTS OF OPERATIONS

(in C\$)	2005	2006	2007	2008E	2009E
Revenues	1,114,439	1,665,706	1,102,539	578,833	1,366,716
COGS	1,924,634	3,499,119	1,747,870	723,541	1,503,388
Gross Profit	(810,195)	(1,833,413)	(645,331)	(144,708)	(136,672)
Expenses					
General & Administration	2,744,434	3,314,283	2,708,111	2,315,332	2,391,753
Stock-based compensation	915,838	493,871	404,494	231,533	546,687
EBITDA	(4,470,467)	(5,641,567)	(3,757,936)	(2,691,573)	(3,075,112)
Amortization	479,226	1,160,334	1,063,862	1,063,862	969,529
EBIT	(4,949,693)	(6,801,901)	(4,821,798)	(3,755,435)	(4,044,641)
Interest Income	40,534	(229,158)	60,281	60,281	5,939
Other Income			45,000		
Loss on write down of Investments and others	(1,297,278)	(272,237)	(10,592)		
EBT	(6,206,437)	(7,303,296)	(4,727,109)	(3,695,154)	(4,038,702)
Taxes/(Income Tax Recovery)	8	(3,968)	1,083	-	-
Net Earnings for the period	(6,206,445)	(7,299,328)	(4,728,192)	(3,695,154)	(4,038,702)
Basic and diluted loss per share	(0.41)	(0.32)	(0.12)	(0.09)	(0.10)

BALANCE SHEETS (in C\$)	2005	2006	2007	2008E	2009E
Assets					
Cash and cash equivalents	1,947,802	1,751,908	1,247,210	172,604	278,597
Accounts receivable	127,599	711,825	834,626	347,300	410,015
Prepaid expenses and deposits	153,902	242,827	157,995	86,825	68,336
Other Receivables	318,406	195,946	15,547	15,547	15,547
Work in progress	375,438	181,040			
Inventory	252,835	260,855	322,316	72,354	150,339
Current Assets	3,175,982	3,344,401	2,577,694	694,630	922,834
Property, plant and equipment	3,367,936	3,470,938	3,113,611	4,847,646	7,605,263
Deferred development and financing costs	1,070,652	883,633	779,391	779,391	779,391
Patents and intangible assets	3,387,921	3,075,633	2,749,351	1,951,455	1,274,308
Total Assets	11,002,491	10,774,605	9,220,047	8,273,121	10,581,796
Liabilities & Shareholders' Equity					
Accounts Payables & Accrued Liabilities	1,279,003	2,241,725	1,011,329	361,771	451,016
Due to related parties	19,637	259,468	-	-	-
Acquisition payment	584,750	35,000	-	-	-
Short-term loans	58,150				
Obligation under capital lease		-	16,805	21,614	144,414
Current Liabilities	1,941,540	2,536,193	1,028,134	383,385	595,430
Deferred rent inducement	70,037	52,528	169,418	152,476	135,534
Convertible debentures	949,185				
Obligation under capital lease		-	21,614	144,414	129,062
Shareholder's Equity					
Share Capital	16,400,927	22,953,387	26,618,974	29,818,974	35,568,974
Contributed surplus	2,158,614	3,419,708	4,297,310	4,384,429	4,802,054
Deficit	(10,517,812)	(18,187,211)	(22,915,403)	(26,610,557)	(30,649,259)
Shareholder's Equity	8,041,729	8,185,884	8,000,881	7,592,846	9,721,769
Total Liabilities & Shareholders' Equity	11,002,491	10,774,605	9,220,047	8,273,121	10,581,796

STATEMENTS OF CASH FLOWS

(in C\$)	2005	2006	2007	2008E	2009E
Operating Activities					
Net earnings for the period	(6,206,445)	(7,299,328)	(4,728,192)	(3,695,154)	(4,038,702)
Items not involving cash					
Depreciation	479,226	1,160,334	1,063,892	1,063,862	969,529
Deferred financing fees		120,394		-	-
Write down and leasehold inducements	1,306,772	247,189			
Stock based compensation	957,028	571,110	479,713	231,533	546,687
	(3,463,418)	(5,200,301)	(3,184,587)	(2,399,759)	(2,522,486)
Changes in non-cash operating working capital	90,049	451,439	(786,915)	158,900	(32,965)
Cash from from (used in) operations	(3,373,497)	(4,748,862)	(3,971,502)	(2,240,859)	(2,555,451)
Investing activities					
PP & E	(2,830,674)	(745,437)	(470,141)	(2,000,000)	(3,000,000)
Patents	(51,835)	(28,322)	(51,507)	-	(50,000)
Deferred development costs and others	(233,263)				
	(3,115,772)	(773,759)	(521,648)	(2,000,000)	(3,050,000)
Financing activities					
Equity	2,540,561	5,384,877	3,988,452	3,200,000	5,750,000
Debt	34,737	(58,150)		(33,747)	(38,556)
	2,575,298	5,326,727	3,988,452	3,166,253	5,711,444
Increase (decrease) in cash	(3,913,971)	(195,894)	(504,698)	(1,074,606)	105,993
Cash beginning of period	5,861,773	1,947,802	1,751,908	1,247,210	172,604
Cash end of period	1,947,802	1,751,908	1,247,210	172,604	278,597

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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