



**FINANCIAL STATEMENTS  
FOR THE NINE MONTHS ENDED  
SEPTEMBER 30, 2004**

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## **MANAGEMENT'S DISCUSSION & ANALYSIS ("MD&A") OF FINANCIAL CONDITION & THE RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED SEPTEMBER 30, 2004 (Form 51-102F1)**

November 29, 2004

### **Introduction**

*Management's discussion and analysis ("MD&A") focuses on significant factors that affected Compliance Energy Corporation performance and such factors that may affect its future performance. In order to better understand the MD&A, it should be read in conjunction with the unaudited consolidated financial statements for the nine months ended September 30, 2004 and the Company's 2003 audited consolidated financial statements and the related notes contained therein. The Company reports its financial statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The Company's significant accounting policies are set out in Note 2 of the audited consolidated financial statements for the year ended December 31, 2003. Additional information on the Company is available in the Company's Annual Information Form, which can be found at [www.sedar.com](http://www.sedar.com) or [www.complianceenergy.com](http://www.complianceenergy.com).*

### **Overall Performance**

The Company recorded a loss of \$206,110 or \$0.01 per share for the nine months ended September 30, 2004 as compared to a loss of \$82,643 or \$0.005 per share for the nine months ended September 30, 2003. As a majority of expenses associated with the development of the Compliance Basin Coal Joint Venture ("CBCJV") have been deferred during the quarter, the Company is only expensing administrative expenses not related to the CBCJV that were incurred during the quarter. The CBCJV is expected to reach commercial production in 2005 and at that time the Company will no longer defer start-up costs. As a result all revenues associated with coal sales from the CBCJV have been netted against the deferred cost of the operation.

Professional fees were \$94,478 for the nine months ended September 30, 2004 as compared to \$40,484 for the period ended September 30, 2003. General and Administrative expenses were \$16,621 for the period as compared to \$18,527 for the same period last year. The Company incurred \$18,499 in transfer agent and filing fees for the nine months ended September 30, 2004 as compared to \$11,184 for the same period last year. Consulting fees of \$26,250 were incurred during the nine months ended September 30, 2004 as compared to nil from the same period last year. Shareholder communication expenses increased to \$40,902 for the nine months ended September 30, 2004 as compared to \$12,854 for the same period last year. This increase in expenditures is as a result of increased public relation activities surrounding the Company's activities. Travel expenses were \$12,237 for the nine months ended September 30, 2004 as compared to nil for the same period last year.

### **Selected Annual Information**

Selected consolidated financial information of the Company for each of the last three completed financial years is detailed in the MD&A accompanying the Company's 2003 audited consolidated financial statements.

### **Liquidity and Capital Resources**

As of September 30, 2004, the Company had working capital of \$2,394,327 (comprised of \$2,189,287 of cash, \$623,797 of receivables and prepaid expenses, offset by \$418,757 of

liabilities) compared with a working capital of \$990,874 at December 31, 2003 (comprised of \$1,056,081 of cash, \$152,048 of receivables and prepaid expenses, offset by \$217,255 of liabilities).

The increase in working capital between December 31, 2003 and September 30, 2004 was a result of the Company closing a private placement with Sprott Asset Management Inc of Toronto for \$1.6 million and having \$1,050,000 worth of warrants exercised.

The following table is selected quarterly financial information derived from the Company's financial statements and should be read in conjunction with the consolidated quarterly financial statements and the audited financial statements for the year ended December 31, 2003.

### Summary of Quarterly Results

Quarter	Revenue	Net Income (Loss)	Basic Earnings (Loss) per Share	Fully Diluted Earnings (Loss) Per Share
September 30, 2004	-	(\$92,073)	(\$0.01)	(\$0.01)
June 30, 2004	-	(\$73,063)	(\$0.00)	(\$0.00)
March 31, 2004	-	(\$40,974)	(\$0.00)	(\$0.00)
December 31, 2003	-	(\$230,128)	(\$0.01)	(\$0.01)
September 30, 2003	-	(\$26,567)	(\$0.00)	(\$0.00)
June 30, 2003	-	(\$34,406)	(\$0.00)	(\$0.00)
March 31, 2003	-	(\$27,237)	(\$0.00)	(\$0.00)
December 31, 2002	-	(\$35,146)	(\$0.00)	(\$0.00)
September 30, 2002	-	(\$10,006)	(\$0.00)	(\$0.00)

In order to better understand Compliance Energy's financial results for the quarter ended September 30, 2004 it is important to gain an understanding of the stage of development of the Company, it's main asset, the Compliance Basin Coal Joint Venture ("CBCJV") of which Compliance holds a 65% interest and is the operator of the project.

The 2003 year was the first year of operation for the CBCJV. Thermal coal sales for the CBCJV for the nine months ended September were \$1.5 million as compared to \$0.5 million for the entire 2003 year, an increase of 300 percent. The Company has chosen to defer these revenues against operating costs for the nine months ended September 30, 2004 as the mine has not yet reached commercial production.

The surge in coal demand over the past year has provided Compliance an excellent opportunity to expand sales. World demand for both thermal and metallurgical coal is expected to remain strong through 2005, primarily as a result of increased demand from China. With this continuing trend, greater growth is expected to continue into next year and Compliance is taking all necessary steps to further expand coal sales in 2005. It is anticipated that commercial production will be achieved in 2005 with increased sales both domestically and on an international basis.

During the quarter the Company announce that it had entered into an agreement to purchase five coal licenses, known as the Bear Met Coal Deposit, covering a total of 2,938 acres from a Vancouver Island private partnership. Under the terms of the agreement, Compliance has made an initial \$40,000 option payment and must make an additional payment of \$100,000 on or before July 31, 2005. The property is subject to a sales royalty of 2.5%.

Previous exploration work on the property has consisted of 36 drill-holes, geological mapping and a 20 tonne bulk sample taken from an adit into the main seam in 1976. Extensive testing of

coal cores and washability analyses of the bulk sample were carried out by Birtley Engineering (Canada) Ltd. All costs associated with the Bear Met Coal Deposit incurred by the Company have been capitalized as Resource Property costs outside of the CBCJV in note 4 to the financial statements. As at September 30, 2004 \$40,000 has been spent on the Bear deposit by the Company. The recommended exploration work will consist of a series of trenches in the low strip ratio areas and analytical test work to clearly define a 70,000 tonne open-pit bulk sample area prior to excavation.

During the quarter the Company continued to advance its wood waste / coal power project near the CBCJV mine site. All development expenses associated with the project are being deferred. A total of \$145,329 of power plant project costs have been deferred during the nine months ended September 30, 2004. In addition, during the nine months ended September 30, 2004 the Company acquired the Coalbed methane gas rights to the area covered by the Company's coal leases. The Company intends to joint venture these gas rights out during the current year.

### **Risks and Uncertainties**

The Company's success depends on a number of factors, some of which are beyond the control of the Company. Typical risk factors include coal price fluctuations and operating uncertainties encountered in the mining business. Competition for the limited Pacific Northwest thermal coal market may make it difficult to penetrate the market. Future government, legal or regulatory changes could affect any aspect of the Company's business, including, among other things, environmental permitting and taxation costs and the ability of the Company to develop an independent power project. These risks and uncertainties are managed, in part by experienced managers, advisors and consultants, by maintaining adequate liquidity and by cost control initiatives.

**COMPLIANCE ENERGY CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

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	September 30, 2004	December 31, 2003
<b>ASSETS</b>		
Current Assets		
Cash	\$ 2,189,287	\$ 1,056,081
Amounts receivable	620,778	126,529
Prepaid expenses	3,019	25,519
	<hr/> 2,813,084	<hr/> 1,208,129
Reclamation bonding	65,000	65,000
Capital assets (note 3)	1,150,719	883,329
Resource property (note 4)	2,359,298	1,474,111
	<hr/> \$ 6,388,101	<hr/> \$ 3,630,569
<b>LIABILITIES</b>		
Current Liabilities		
Accounts payable	\$ 418,757	\$ 132,255
Due to related parties	-	85,000
	<hr/> 418,757	<hr/> 217,255
Non-current Liability		
Deferred Gain on Joint Venture Formation	772,471	772,471
	<hr/> 1,191,228	<hr/> 989,726
<b>SHAREHOLDERS' EQUITY</b>		
Share Capital (note 5)	5,705,671	2,943,531
Contributed surplus	80,500	80,500
Deficit	(589,298)	(383,188)
	<hr/> 5,196,873	<hr/> 2,640,843
	<hr/> \$ 6,388,101	<hr/> \$ 3,630,569

Interim Financial Statements (Note 1)

Approved by:

"James C. O'Rourke" Director  
James C. O'Rourke

"Rodney A. Shier" Director  
Rodney A. Shier

The accompanying notes are an integral part of this financial statement

**COMPLIANCE ENERGY CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003**

	Three Months Ended Sep 30, 2004	Three Months Ended Sep 30, 2003	Nine Months Ended Sep 30, 2004	Nine Months Ended Sep 30, 2003
<b>REVENUES</b>				
Interest Income	\$ 458	\$ -	\$ 2,877	\$ 406
	458	-	2,877	406
<b>EXPENSES</b>				
Professional fees	52,478	19,483	94,478	40,484
General & admin	4,251	17,423	16,621	18,527
Consulting fees	7,500	-	26,250	-
Transfer agent & filing fees	6,672	5,915	18,499	11,184
Shareholder communications	15,948	3,161	40,902	12,854
Travel	5,682		12,237	-
Net loss before other item	92,531	45,982	208,987	83,049
<b>NET LOSS FOR THE PERIOD</b>	92,073	45,982	206,110	82,643
<b>DEFICIT (RETAINED EARNINGS), BEGINNING OF PERIOD</b>	497,225	101,511	383,188	64,850
<b>DEFICIT (RETAINED EARNINGS), END OF PERIOD</b>	\$ 589,298	\$ 147,493	\$ 589,298	\$ 147,493
<b>LOSS PER SHARE</b>	\$ 0.01	\$ 0.00	\$ 0.01	\$ 0.01

The accompanying notes are an integral part of this financial statement

**COMPLIANCE ENERGY CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003**

	Three Months Ended Sep 30, 2004	Three Months Ended Sep 30, 2003	Nine Months Ended Sep 30, 2004	Nine Months Ended Sep 30, 2003
<b>OPERATING ACTIVITIES</b>				
Net loss for the period	\$ (92,073)	\$ (26,567)	\$ (206,110)	\$ (82,643)
Items not involving cash:				
Net change in non-cash working capital items	(161,522)	44,376	(270,247)	(76,737)
	(253,595)	17,809	(476,357)	(159,380)
<b>INVESTING ACTIVITIES</b>				
Purchase of capital assets	(116,501)	(83,957)	(267,390)	(283,580)
Resource property costs	(377,612)	(304,508)	(885,187)	(633,726)
	(494,113)	(388,465)	(1,152,577)	(917,306)
<b>FINANCING ACTIVITIES</b>				
Shares issued for cash	-	462,000	2,762,140	923,689
	-	462,000	2,762,140	923,689
<b>INCREASE IN CASH</b>	(747,708)	91,344	1,133,206	(152,997)
<b>CASH, BEGINNING OF PERIOD</b>	2,936,995	196,976	1,056,081	441,317
<b>CASH, END OF PERIOD</b>	\$ 2,189,287	\$ 288,320	\$ 2,189,287	\$ 288,320

The accompanying notes are an integral part of this financial statement

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2004**

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**1. BASIS OF PRESENTATION**

These interim period consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles (“GAAP”) with respect to the preparation of interim financial information. Accordingly, they do not include all of the information and disclosures required by Canadian GAAP in the preparation of our annual consolidated financial statements. Certain information and footnote disclosure normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted. The accounting policies used in preparation of the accompanying unaudited interim consolidated financial statements are the same as those described in our annual consolidated financial statements and the notes thereto for the two years ended December 31, 2003.

These interim period statements have not been reviewed by the Company’s auditors and should be read together with the audited consolidated financial statements and the accompanying notes included in the Company’s latest annual report.

**2. CONTINUANCE OF OPERATIONS**

These interim consolidated financial statements have been prepared on a going concern basis, which assumes the ongoing capacity of the Company to realize on its assets and discharge of liabilities in the normal course of business. The Company’s status as a going concern is dependent on its ability to generate future profitable operations and to receive continued financial support from its lenders and shareholders. Management is of the opinion that sufficient working capital will be obtained from operations and external financing to meet the Company’s liabilities and commitments as they become due. Should the going concern assumption not be appropriate, the carrying values and classifications of assets and liabilities would change and those changes could be material. It is not possible to predict the outcome of those matters at this time.

**3. PROPERTY, PLANT AND EQUIPMENT**

	September 30, 2004	December 31, 2003
Proportionate interest at cost in the property, plant and equipment of the CBCJV:		
Land	\$ 32,500	\$ 32,500
Building	148,061	148,061
Equipment	951,288	702,110
	<u>1,131,849</u>	<u>882,671</u>
Equipment owned outside of the CBCJV	18,870	658
	<u>\$ 1,150,719</u>	<u>\$ 883,329</u>

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2004**

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**4. RESOURCE PROPERTY**

The Property consists of 9 coal licenses covering 2,172 hectares, and was acquired by the CBCJV pursuant to a Mining Agreement dated August 30, 2002. Under this agreement, the CBCJV acquired working rights to the Property and a Right of First Offer in respect to any future disposition of the mineral tenures and related royalty comprising the Property. In consideration, the CBCJV granted a royalty of 3% on gross coal revenue from the Property prior to December 31, 2004, and of \$1.50 per tonne on all coal production thereafter.

The details of the carrying amount of the Company's resource property costs are as follows:

	September 30, 2004	Cumulative to December 31, 2003
Proportionate share of deferred costs incurred by the CBCJV:		
Mining	\$ 1,236,203	\$ 535,221
Processing	535,081	250,401
Development	1,055,526	546,819
Marketing	114,548	69,011
Environmental	140,856	105,160
Legal	34,130	34,130
	<u>3,116,344</u>	<u>1,540,742</u>
Less: start-up Coal Revenue	(1,335,537)	(332,875)
	<u>1,780,807</u>	<u>1,207,867</u>
Deemed project value	*1,700,833	*1,700,833
Less: the Company's interest in the aggregate gain realized to December 31, 2002 on its vend-in to the CBCJV.	(1,434,589)	(1,434,589)
	<u>2,047,051</u>	<u>1,474,111</u>
Other deferred costs outside of the CBCJV	312,247	-
	<u>\$ 2,359,298</u>	<u>\$ 1,474,111</u>

\* Aggregate value ascribed to the Coal Project at the outset of Compliance's vend-in to the CBCJV.

**5. CAPITAL STOCK**

- (a) Authorized  
1,000,000,000 Common shares without par value  
20,000,000 Preferred shares without par value

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2004**

**5. CAPITAL STOCK (Cont'd)**

(b) Issued

	Common Shares	Amount
Issued at December 31, 2003	23,508,096	\$ 2,943,531
• Shares issued for cash (net of costs)	5,638,700	2,762,140
Issued at September 30, 2004	29,146,796	\$ 5,705,671

(c) Escrowed Shares

Pursuant to the terms of the business combination completed during the year, at September 30, 2004 there were 9,238,940 common shares still held in escrow. These shares are subject to a six year hold period that started March 5, 2003 and their release from escrow is subject to the terms of an agreement between the shareholders, the Company, and the transfer agent, Computershare Investor Services Inc.

(d) Stock Options

As at September 30, 2004, the Company has reserved stock options to directors and officers enabling them to acquire up to 940,000 common shares of the Company as follows:

Options Outstanding	2003		2002	
	Number of shares	Weighted average exercise price Cdn. \$	Number of shares	Weighted average exercise price Cdn. \$
Beginning of year	135,000	0.30	135,000	0.30
Granted during year	855,000	0.30	-	-
Exercised during year	50,000	0.30	-	-
End of year	<u>940,000</u>	0.30	<u>135,000</u>	0.30

The weighted-average remaining life of options outstanding at June 30, 2004 is 3.5 years.

(e) Warrants

As at September 30, 2004 100,000 warrants are outstanding entitling the holders to acquire shares of the Company at an exercise price of \$0.40 per share exercisable up until November 25, 2005.

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2004**

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**6. RELATED PARTY TRANSACTIONS**

All transactions with related parties have occurred in the normal course of the Company's operations and have been measured at their fair value as determined by management.

- The Company paid one of its officers legal, management and administration fees aggregating \$63,000 during the period ended September 30, 2004 (period ended September 30, 2003 - \$59,500).
- The Company incurred consulting fees for project development costs of \$45,000 for the period ended September 30, 2004 (period ended September 30, 2003-\$90,000) with a private company controlled by the family of a director and officer.

Refer also to note 4.

## **Corporate Information**

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### **Head Office**

Compliance Energy Corp  
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Fax: (604) 681-5910

### **Mine Office**

Compliance Coal Corp  
*DBA Compliance Basin Coal JV*  
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Tel: (250) 295-0479

Fax: (250) 295-0476

### **Registrar and Transfer Agent**

Computershare Trust Corporation of Canada  
Vancouver, British Columbia

### **Exchange Listing**

TSX Venture Exchange  
“CEC”

### **Web Page**

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