

# Growth Stocks Weekly

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**Growth:** 1996 116.9%; 1997 28.1%; 1998 36.4%; 1999 39.4%; 2000 180.9%; 2001 -50.5%; 2002 18.7%; 2003 28.8%; 2004 166.7%; 2005 28.2%; 2006 153.3%; 2007 8.8%; 2008 -25.2%; 2009 -50.3%

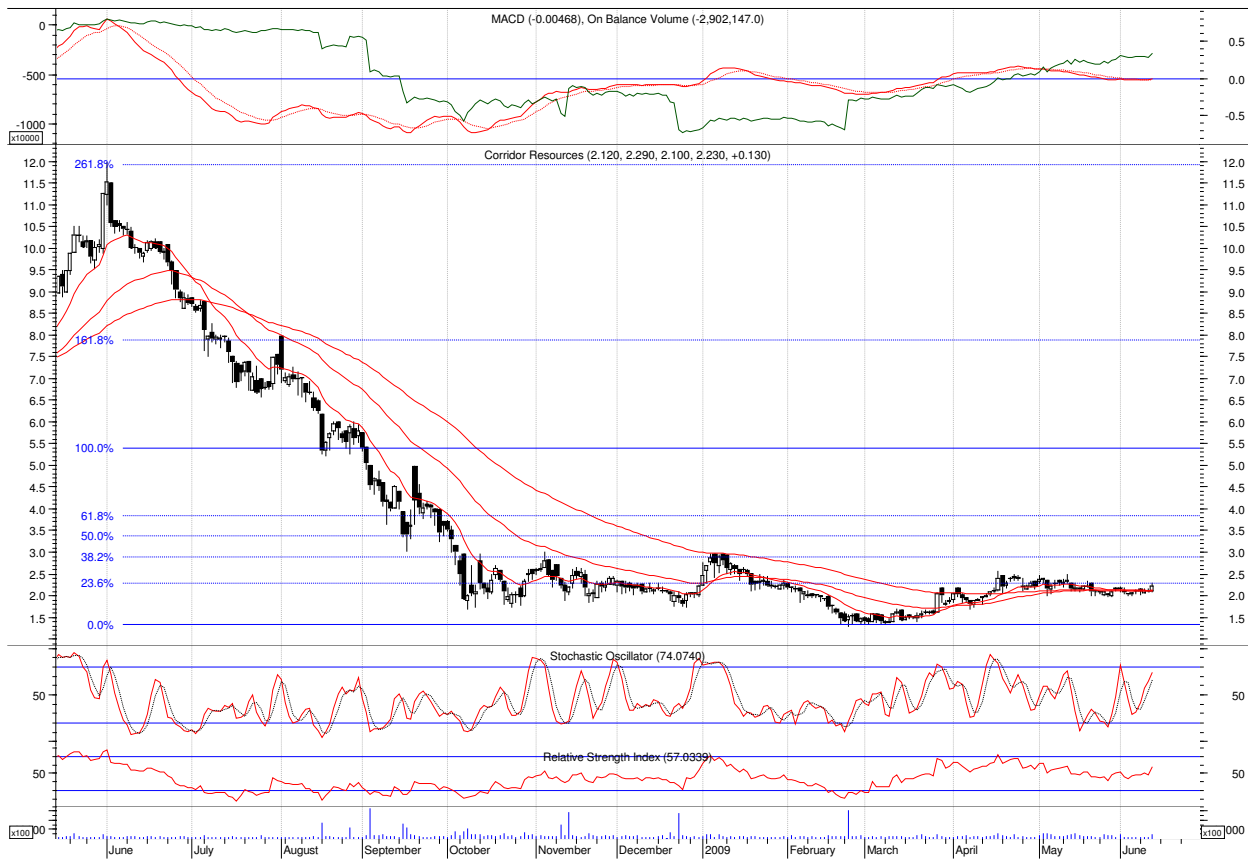
## Junior Gold and Natural Resource Sector Report

June 11, 2009

### Seeking Refuge in Natural Gas

### CORRIDOR RESOURCES (CDH-TSX)

#### Initial Report



**Daily chart: High \$11.96, Low \$1.29, Last \$2.23**

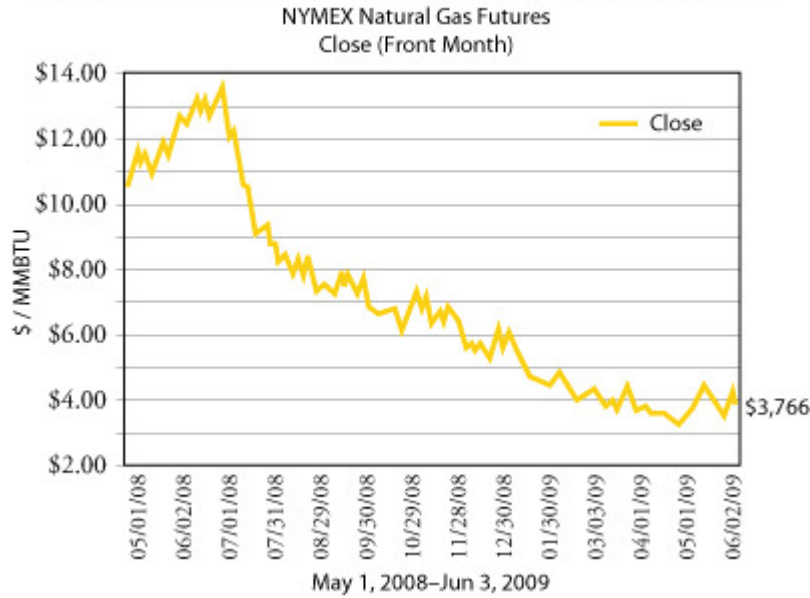
It's a tough market in which to find a true bargain that hasn't run up a whole lot. Many stocks are up more than 100% since the recent lows – three up more than 200%, and two up about 400%.

Of course you've probably heard how the market rallied 41% in early 1930 after the crash of 1929, before the market went on to make new lows and suffered years of tough times. I don't believe this is 1930, but one needs to carefully pick entry points here to avoid any severe correction that may strike at any time. I believe I've found a great place to hide - in natural gas.

Natural gas is more than a place to hide. It is simply super cheap. As most other commodities - including oil - have rallied, natural gas remains mired down near its lows. The ratio of the price of crude oil to the price of natural gas topped 18-to-1

recently, which we have not seen since 1990, according to Barron's. The following chart shows what's happened to natural gas over the last year:

### Natural Gas: Like Jumping off a Cliff in Acapulco

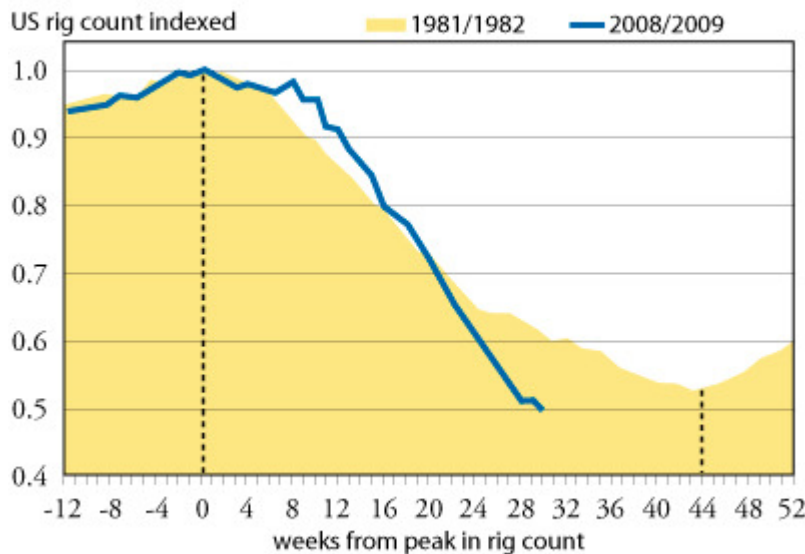


A lot of investors in natural gas producers have taken the proverbial swan dive, with many charts in the sector resembling the Natural Gas chart. Sentiment is so bad it's hard to believe it getting worse, and my readers should all know by now that markets discount future expectations. Can expectations get any worse? If not, then it's hard to imagine a better time to buy a natural gas producer.

Natural gas fell because there was too much of it. We are in a recession, and industrial demand for natural gas has fallen through the floor. We saw a lot of over investment in the sector, with aggressive exploration and development, and the opening up of vast tracts of shale gas plays. Now, producers are cutting back. And the decline rates on those gushing shale gas plays (which helped contribute so much gas to the pool) are 60-75%. This means that if these producers don't drill, the flow of gas from their wells will fall by that much in the first year.

So obviously they aren't drilling as much. The rig count has collapsed. It has fallen much faster than even during the 1981/82 collapse, the worst since the Great Depression.

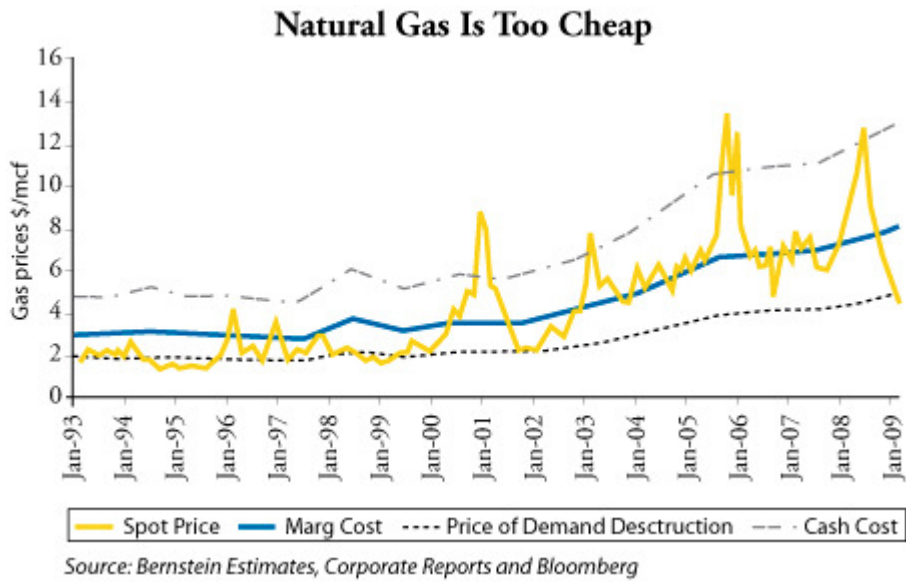
### Drilling Has Collapsed



Source: Baker Hughes, FactSet, Morgan Stanley Research

The marginal cost to produce natural gas for the vast majority of the industry is probably somewhere around US\$6-8. The next chart gives you a good snapshot of what the U.S. gas situation looks like.

The key to this chart is to see how the spot price of natural gas bounces off that cash cost line. No one makes any money below cash costs, and you are not likely to stay there for long. Likewise, you see demand for natural gas drop when it gets to the upper dotted line. The marginal cost is the predictor to watch, though. Most of the time, the natural gas price will gravitate toward that line.



Right now, the spot price of natural gas is under \$4 and sits right on the industry's cash costs and well below marginal costs. In short, natural gas supply is going to start to dry up here really soon.

In this market, where nearly everything is rallying, I believe you can safely buy a carefully selected gas producer, because the stock price has already been severely pounded. Make sure it's debt-free and a low-cost producer, that is still profitable even at these low prices for natural gas - and that it trades for half of the value of its proven and probable reserves, and it becomes a value play. Add in huge acreage for its other prospects and you can get a good argument for a potential re-pricing to more than four times today's trading price.

The company is **Corridor Resources (CDH-TSX)**, based in Halifax, Nova Scotia. It enjoys an enormous land position in a key area. There are at least a few good reasons to like natural gas in Eastern Canada. It is close to gas-hungry markets along the Eastern seaboard. It also holds sweet gas, which enjoys a premium over the quoted natural gas price. Royalties are still attractive as governments haven't tried any cash grabs like in Alberta. Their unexplored acreage is large with lots of potential.

Corridor's lone producing asset hooks up to the Maritimes & Northeast Pipeline (M&NP). The M&NP runs about 870 miles and services Atlantic Canada and the Northeastern U.S. down to Boston. It goes from Nova Scotia and New Brunswick down through Maine, New Hampshire and Massachusetts, where it connects with the Algonquin Gas Transmission's HubLine.

Corridor owns a gas-gathering system and a 31-mile pipeline that connects its producing field to the M&NP. And it has acquired most of the prospective lands along the M&NP pipeline. So it has good infrastructure and an important long-term competitive advantage in its location.

Corridor's one producing asset is the McCully Field, located near Sussex, New Brunswick. Corridor produces gas in partnership with PotashCorp - which as a maker of fertilizers uses a lot of natural gas (fertilizer producers are among the biggest consumers of natural gas).

Corridor's McCully/Elgin interests cover over 320,000 net acres. Currently, production is about 17 million cubic feet of gas per day (MMcf/d), with more coming online this summer. The cash flow generated from this production keeps the company going and funds its development efforts.

Fully diluted, there are 89.3 million shares of Corridor Resources. As I write, the stock trades for C\$2.23. The market puts the value of the company at only C\$199 million.

Based only on Corridor's proven and probable reserves, Corridor is worth significantly more. The industry uses something known as PV-10 methodology, which is simply based on current production and expenses. Corridor's PV-10 values are

available in public disclosure documents, and provide a rough estimate of the value of future cash flows from present-day reserves. This basic net asset value (NAV) works out to C\$346 million, which is about C\$3.90 per share - that's a 75% gain from here. And that's just proven and probable reserves, ignoring potential reserves or their other projects.

Also, there is substantially more to Corridor than just its proven and probable reserves. The company has an additional 110 Bcf of possible reserves. These reserves are more speculative and, thus, discounted more heavily in the valuation. Using the same PV-10 methodology, Corridor's NAV rises to C\$538 million, or over C\$6 per share.

Corridor also has 1.85 million net undeveloped acres in New Brunswick, Newfoundland, Prince Edward Island and Quebec. These basins hold trillions of cubic feet (Tcf) in natural gas accumulations. They are company makers. The Frederick Brook Shale, underlying McCully and Elgin, could be a world-class asset. Corridor estimates 20 Tcf of gas in place, with 15%-20% possibly being commercially recoverable. The Hiram Brook Shale, also in McCully, is another multi-Tcf opportunity. Corridor also has other big impact opportunities, such as with Old Harry, in the Gulf of St. Lawrence, which holds oil.

Altogether, Corridor has a huge land position for a company its size and lots of potential for large natural gas finds. When you weigh these potential shale assets and other prospects, it is not hard to get a stock price of C\$8-11 per share - that's a potential gain of 250-400%. Keep in mind the stock was trading at C\$11 last June.

This year, the company should generate about C\$35 million in operating cash flow, or about 40 cents per share. On this basis, the stock trades for only about 5 times cash flow. That cash flow will fund development Capex of C\$41.5 million, with the balance coming from cash on hand. So the company is cash flow positive, even in this environment.

Corridor is also debt free, a good position to be in to wait out the low natural gas prices. As at March 30 Corridor had C\$22 million in unrestricted cash and an unused C\$40 million line of credit. So it has a very clean balance sheet.

Management and the board of directors own 8.4% of the stock. The board recently approved the repurchase of up to 1 million shares of stock. Ultimately, Corridor will be a likely acquisition target when natural gas prices improve. Someone with far deeper pockets, looking for sizable natural gas deposits, will come along and pay a big premium to get hold of Corridor.

Obviously better natural gas prices would be a catalyst for an upward re-pricing of the share price. Corridor hired GLJ Petroleum Consultants to evaluate the resource potential in its McCully and Elgin properties. We should have the report sometime this month. Corridor's internal estimates have been in the range of 20 Tcf of gas in place, but the market will like the third-party evaluation, and this may also attract an upward revision to the market valuation.

### **Conclusion**

Currently the market is very bearish on natural gas, and given Corridor's large reserve base and exploration potential the market obviously thinks it will be years before any of that turns into cash. Corridor is being priced as dead money. Corridor is a relatively small operation in a market littered with struggling small caps, so it's easy to get missed by value-seeking energy funds.

Corridor hasn't lost anything from when it was trading for C\$11 per share last summer. It has the same assets and the same story. What it needs is natural gas prices to recover, and it needs to further develop its assets. It could also benefit by attracting a bigger partner to develop the massive Frederick Brook Shale.

Meanwhile, given its debt-free balance sheet and low costs, we would be well positioned to wait for the rebound that will eventually come. We wish to establish a 50,000 share position for the GSW Model Portfolio under C\$2.50 per share.

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