

**Today's Notes:**

- 1. The Debt Bomb (Submitted by Christopher Berry)**
- 2. Quatterra Resources: The New Model of Extractive Industries**

## **1. THE DEBT BOMB: PAIN**

For all the ink spilled during the past 18 to 24 months regarding banking woes, there is another, perhaps more sinister problem that has been comparatively overlooked. It is becoming clear that debt on balance sheets of sovereign nations is out of control. For a few countries in particular, it's time to pay the piper.

A case in point is Greece. The governments of both Iceland and Latvia have preceded this country in collapsing, but what is most surprising is the fact that a member of the Euro zone has followed suit— a developed rather than a developing nation is experiencing these issues for the first time. With a debt to GDP ratio of 138% and skyrocketing short-term bond yields it's worth looking at how Greece got itself into this mess and what lessons we can learn from it.

A yawning budget deficit (forecast to rise to 12.7% of GDP in 2010) and no apparent political will to change tack, bode ill for the Greek populace and the Euro zone as a whole. EU membership guidelines stipulate that budget deficits must not exceed 3% of GDP. On our shores in the United States, with a yawning budget deficit (12.3% of GDP in 2009 and growing) and also no political will to change, are we far behind?

The title of President Obama's FY 2010 Budget document (The Budget of the United States Government: Fiscal Year 2010),

“A New Era of Responsibility: Renewing America's Promise” makes me cringe.



With entitlements such as Social Security and Medicare coming due to a growing cadre of Baby Boomers, along with funding for multiple wars, and a seemingly endless list of “too big to fail” organizations needing tax payer dollars to stay afloat, can the end game be far off? I’m sure there are lots of folks in Iceland, Latvia, Greece (and most recently Dubai) that ignored these warnings and now wish they could turn back the clock. The days of the West lecturing other countries on how to manage their finances, be it China, Greece, or whoever - are over. With red ink as far as the eye can see on U.S. shores, we’ve clearly lost the moral authority on financial stewardship.

This begs a question growing in importance each day – who will lead us (the U.S., Greece, or the world economy for that matter) out of this mess and onto a more fiscally responsible path? China? Doubtful. The model of economic growth in that glorious country is founded upon exports. A cheap Renminbi aids the Middle Kingdom’s exporters to “make stuff” to sell to the rest of the world – predominantly the US and Euro zone. However, as I mentioned, with the US hopefully now emerging from the deepest recession since the Great Depression and various Euro zone members teetering on the verge of bankruptcy, China’s development model isn’t the savior. The Euro zone? Too much debt, sclerotic labor laws, and an over-reliance on the US as the “consumer of last resort” lead us to believe the Euro zone isn’t the answer.

So that brings us back to the U.S. as the last realistic hope before more countries go the way of Greece. It was the famous Greek philosopher Aristotle who said, “We cannot learn without pain.” Those of us here in the US should heed the words of this man and get ready for fewer benefits, higher taxes, and – in short – lots of pain.

## **2. QUATERRA’S BUSINESS MODEL**

Three years ago, long before the Paulson speech and the ensuing calamity of July 2008, I began to realize that Dr. Tom Patton CEO of Quaterra Resources (QMM NYSE AMEX, QTA TSXV) was inventing a new business model in the extractive industries. Following Secretary Paulson’s speech guaranteeing China’s mortgage bond investments, as the debt crisis worsened, two things became obvious:

- 1) Financing junior exploration and biotech companies was almost impossible.
- 2) New approaches to raising capital would become critical if the resource and drug discovery pipelines were to remain filled.

In 2005 I began talking about the Quaterra “pipeline.” I put forth the idea that the venerable Patton and his team were acquiring mining properties that had potential for “world class” discoveries based on the “best draft choice” option. Properties would enter the QMM pipeline, Quaterra would spend and develop them with all the tools at the company’s disposal (geophysics, mapping, drilling, geoengineering, the best discovery people, etc.) and the properties would accrete in value in Phase II as they approached feasibility. In Phase III the Quaterra team would “monetize” the properties by selling, joint venturing or developing them to production. One requirement was critical. All properties entering Phase I of the QMM Pipeline had to be owned 100% by QMM.

This requirement would be critical because it would later facilitate the monetization strategy.

Earlier this year, in fact just a few months ago, a number of writers caught on to this business model. As applied to extractive industries. Dave Forest wrote in September 25th on companies that acquired numerous properties that were “ideas” and the companies became idea factories with risk diversification and multiple value creating opportunities<sup>1</sup>. More recently my colleague Jay Taylor recommended TNR Gold in the same context. He referenced TNR Gold as a “project generator.”<sup>2</sup> It would seem that this business model for Incubator companies (those once called Penny Dreadfuls) is a very useful one indeed.

Yesterday Goldcorp and Quaterra Resources jointly announced a deal on Quaterra’s Mexican properties. Quaterra, under Dr. Patton’s guidance, has been quietly accumulating properties in central Mexico with “world class” discovery potential. The company now controls a 100% interest in more than 1000 square miles of property in three states. Goldcorp will invest \$10 million in QMM shares over two years to earn an option on any single Mexican property. It may choose more than one property to continue funding development. If Goldcorp chooses to option any QMM property they will spend \$2 million on it in a two year period of development of the property and carry the project to bankable feasibility to earn a 65% ownership. The agreement is essentially a “carry to production” on any property on which QMM makes a discovery<sup>3</sup>.

This means that QMM’s exploration activities in its massive Mexican portfolio are carried for the next two to three years. No more shareholder dilution. No more capital market shreking for equity. Having a partner in Goldcorp, with one of the largest exposure s in Mexico and deep pockets, is highly significant.

This is a very good deal for Quaterra shareholders. Within the past decade two of the largest mines have been developed in central Mexico. Peñasquito is one of those discoveries. It is now owned by Goldcorp. It was, in fact, originally discovered by Dr. Patton’s team (Mexican Field Boss Tom Turner) when part of Western Silver.

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<sup>1</sup> A few weeks ago I discussed methods for valuing mineral exploration projects, and asked the question, "What's an idea worth?" This week I want to expand on that concept by looking at how exploration ideas are generated in the mining businesses. Although this is a somewhat esoteric topic, it is far from academic. Major mining companies around the world are increasingly willing to pay top dollar to junior firms with the ability to come up with solid exploration ideas. If you want to be successful in junior mining investment, you need to understand what makes a good exploration concept. We'll look at some examples of how junior companies have successfully used exploration expertise and creativity to build inventories of projects.  
<http://mail.google.com/mail/?shva=1#search/idea+factory/123f68260a70528a>

<sup>2</sup> “TNR Gold Corp. is employing the project generator model. For those of you who may not know what a project generator model is, a word of explanation is in order. “*Project generators*” are companies that pick up early stage exploration ground when there are historical or scientific reasons to believe a property is prospective for a given mineral. Because these properties are obtained at an early stage of development, the cost of obtaining them is very low.

As a project generator, TNR then uses its intellectual capital rather than hard currency capital to add value to its shareholders. By carrying out relatively low cost early exploration work, it demonstrates with greater confidence, the potential for a given property to host an economically viable mineral deposit. At that point in time, TNR hopes to bring in other companies that are willing and able to spend considerably more money to explore and advance those prospects toward production. TNR will generally retain a carried interest in those prospects into the future or at least a Net Smelter Return on any future production from the property. The prospect generator model is in theory a less risky model because, if other companies are spending considerable amounts of money, they can reduce the number of shares issued to raise capital.”

<sup>3</sup> The agreement is a 65 /35 carry to bankable feasibility on any property that Goldcorp chooses. Imagine what owning 35% of Peñasquito would have meant for any shareholder in Western Silver.

The QMM business model (Idea Factory, Project Generator, or Pipeline call it what you wish) is still open. All three phases are operating full blast:

- 1)Phase I acquisition,
- 2) Phase II development and
- 3) Now phase III property monetization.

The US pipeline is stocked. Molybdenum in Texas (on state land) MacArthur (Yerington Nevada) copper now looking good and Duke Island being JV'd with Copper Ridge.

Earlier this year Quaterra consumated an excellent deal with the world's largest public copper miner Freeport McMoRan on the company's Southwest Tintic copper project. This was also a 70/30 carry to bankable feasibility pending drill results this spring.

The bottom line for QMM investors:

This industry's giant players are recognizing the Patton (QMM) business model as being revolutionary- both Goldcorp and Freeport are now invested in QMM's open pipeline. The equity market is also recognizing the company. I think the shares have upside potential if, as I expect, new discoveries are made. The track record suggests this could happen in 2010. Look for the QMM pipeline to continue to be stocked with properties owned 100% that have world class potential.



Goldcorp's Exploration Chief Charles Ronkos said,

***"This agreement brings together two talented teams that separately delineated and built the world-class Peñasquito deposit. Joining forces to explore this prolific area will increase our chances to make additional important discoveries."***

Quaterra's CEO Tom Patton said,

***"This agreement provides a strong incentive for us to be successful in our exploration efforts," says Quaterra President and CEO Thomas Patton. "In the generative phase, Quaterra will be relying on the same exploration team that made the initial Peñasquito discovery in Zacatecas State, Mexico, which was later acquired by Goldcorp. In the advanced phase, Goldcorp has the option to bring its formidable development and mine building expertise to the table."***

Please read the press release and look for a New Year filled with discovery potential for Quaterra, Goldcorp and Freeport. I own shares in both QMM and GG.

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