SMALLCAP INSIDER

APRIL 2012, VOLUME 1, ISSUE 5

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This issue went to print 3/29/12. Prices and margins quoted reflect levels at this date.

Drilling Into the Future

This trio of companies makes fracking safe, cheap… and profitable

by Ryan Cole

Fracking may be the hottest way to drill for oil and natural gas… but it's already old news.

If you follow the press you know, in addition to unlocking vast quantities of petroleum, fracking also unlocks vast amounts of vitriol.

Ecologists hate it. Local communities affected by drilling hate it. Sometimes, it seems like our politicians hate it too — just look at all the new regulations that are currently being bandied about in Congress.

But you know what? That's the old version of fracking. That's the past.

The future is now. I call it Fracking 2.0 — because this is clearly second-generation technology.

In the new world of fracking…

- We won't have to worry about chemical seepage; chemicals are being eliminated.
- We won't have to worry about water contamination — because we've found ways to clean the water, when it isn't taken out of the loop entirely.
- By the same token, we won't have to worry about access to water — a major issue in arid regions like Texas or in cold spots like the tundras of the Bakken in Canada.
- All sorts of costs associated with transporting water… storing water… disposing wastewater… all can be eliminated, overnight.

In fact, most of the problems associated with fracking are related to water — and, as fracking becomes more pervasive, you can believe that public outcries will increase as well.

It's already happening.

Canada has passed environmental regulations related to fracking, and North Dakota is about to. Cities in New York and Ohio have banned fracking.

Congress is about to require greater transparency regarding the chemicals being sent into the ground. At the same time, the Environmental Protection Agency and Department of the Interior are looking at measures they can take to ensure wastewater is properly cleaned.

But all those headaches are being solved for drillers, thanks to companies responsible for what I call Fracking 2.0.

Rather than worry about protesters, drillers can focus on the enormous new reserves they can now tap with fracking (1.8 trillion barrels in the U.S., conservatively — enough to make Saudi Arabia jealous).

Rather than worry about government interference, they will be able to focus on exploration and recovery.

And rather than try to guess which companies will strike black gold… or whether this sudden influx of gas and oil will result in oversupply and lower prices… investors like you and me can focus on the businesses bringing the technology that's making Fracking 2.0 a reality.

With these plays, the price of oil and natural gas doesn't matter — what matters is you can't begin to get at this oil

without this new technology (thanks to the aforementioned legislation on the way). No matter where oil is selling, these energy service companies will be doing brisk business — because drillers won't long have a choice.

Some businesses are quickly charging ahead — already far exceeding their own guidance. Some are laying the groundwork for the most exciting advances. And some are helping with the transition — cleaning up the way we currently frack, while preparing businesses for the future.

In this issue, we're going to take a look at three companies solving fracking's woes, at various stages in the transition to Fracking 2.0.

But we're getting ahead of ourselves. First, we need to go over exactly what fracking is — and why it's so important.

A Quick Fracking Primer

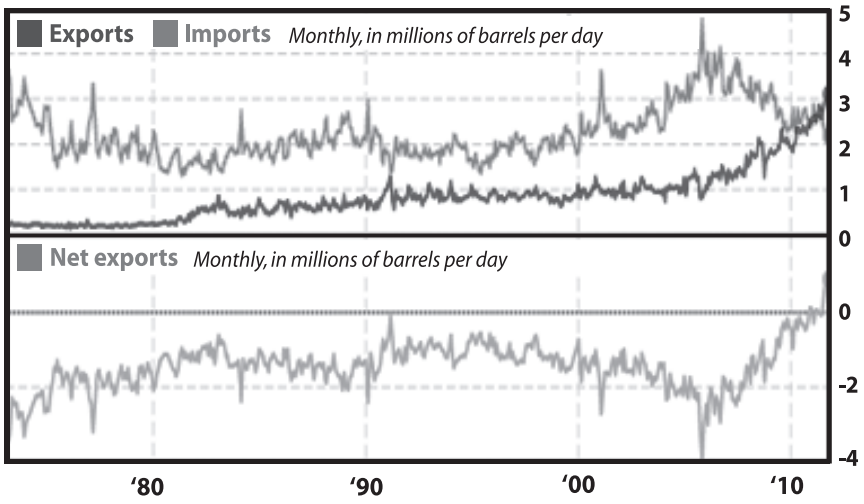
Last year, the U.S. became a net exporter of refined petroleum goods.

It's hard to believe, as somehow the mainstream media has missed this huge story, but it's true. For the first time in decades, the U.S. is selling more refined oil products than it's buying.

Granted, we still don't produce as much crude oil as we bring in, but nevertheless, this is a real achievement — one we haven't seen in decades, and one many thought we'd never see again.

The fact of the matter is, the long decline in U.S. oil production has been in reversal the past three years.

U.S. TRADE IN REFINED OIL PRODUCTS



SOURCE: Bloomberg

Reduced consumption plays a role, but so does fracking — new technology that's unlocking approximately 1.8 trillion barrels of oil that were previously inaccessible.

And that's just to start. As technology improves, another 4 trillion barrels may lay in wait. Not to mention the 482 trillion cubic feet of natural gas recoverable right now — a number that could easily jump to 2,543 trillion cubic feet as technological advances (like Fracking 2.0) give us greater access to previously unrecoverable deposits.

Let's put those numbers in perspective.

Today, Saudi Arabia has 264 billion barrels of proven oil reserves — about one-seventh the oil the U.S. has locked in its shale. And Saudi Arabia has about 189 trillion cubic feet of natural gas — just a bit more than what the U.S., today, can recover from the Marcellus Shale region alone.

You see how powerful fracking is — it's rewriting the oil maps of the world, and shifting power in the Great Game. Fracking could break the back of OPEC. It could lead to a fall in oil prices similar to the fall we're currently seeing in natural gas.

That's why we're not investing in the producers — they might be facing a supply glut that keeps earnings down. But the companies that service oil producers — they're looking at an incredible boom in wells, regardless of the price of the underlying commodities.

Here's how this powerful technology works…

In the simplest terms, fracking is the injection of water and chemicals into gas- and oil-rich shale rock. The pressurized water breaks up the rock, and the chemicals help dissolve it, lubricate the shale and thicken the water so it's more effective.

In slightly more detail, fracking is possible thanks to horizontal drilling.

The initial well is drilled… and, when it reaches shale, the bore hole travels sideways, inside the vein of shale. Once in place, small explosive charges are set off to create holes in the pipe, and begin the process of cracking the oil-rich rock all along the horizontal bore.

That's when water is injected at very high pressure, along with hydrochloric acid and other chemicals to help break and dissolve the rock, sand to hold open the cracks caused by chemicals and water, lubricants to help the sand travel, and thickeners to give the water more heft.

Once the shale is fractured (hence hydrofracturing, or fracking) the oil and/or gas travel back up the bore, along with wastewater. Once to the surface, the petroleum products are separated out and processed.

The water, though, is a real problem. No one has come up with a perfect way to clean it… until now.

Storing the wastewater has been a real problem — with leaks polluting local aquifers (a problem that one of the companies I have uncovered has solved, with an ingeniously simple — and significantly cheaper — solution).

Worse still, wastewater comes with an unwanted passenger — radioactivity. Shale rock is naturally radioactive — in fact, reading radioactive measurements lets drillers know when they've hit shale and should start drilling horizontally.

To be clear, there's no data showing this trace amount of radioactivity is dangerous. Some houses have been built directly on exposed shale, without any ill effects for residents.

That said, radioactive water is a public relations nightmare. It has the EPA looking at drilling sites as possible Superfund candidates. And there's no good way to clean water once it has been exposed to radiation.

But what if we didn't have to use water? My third pick has a solution that is just now going into drill sites and could eliminate the need for water once and for all.

We'll get to that in a moment; first, let's look at our simplest water solution. It is a company regulators themselves are recommending.

Swimming in Profits

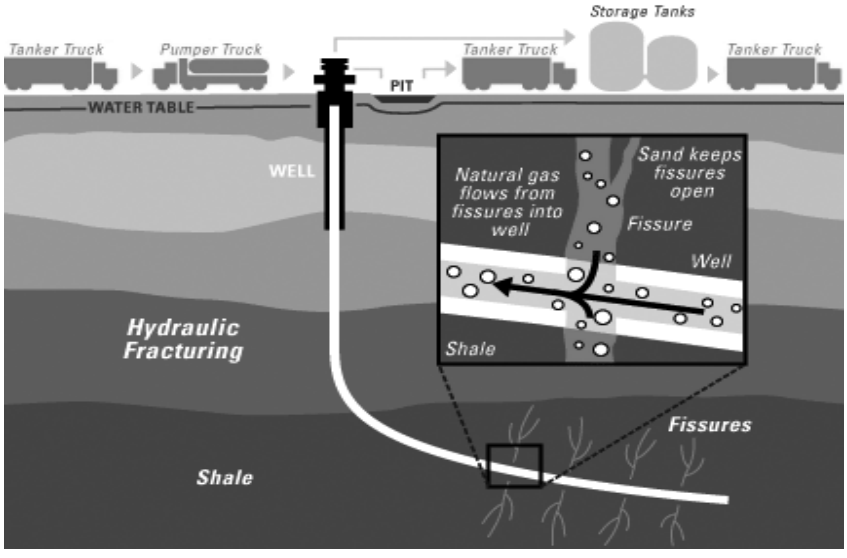
Believe it or not, water transportation is one of the biggest issues facing traditional fracking sites.

And we're not just talking about the uproar that using gallons of freshwater causes. Sure, it's a big deal that Marcellus wells use about as much freshwater as Pittsburgh each year… and it's an even bigger issue in arid regions like Texas.

When droughts hit and yet drillers continue to pour water down holes in the earth — much of it never to re-emerge, the rest spoiled with chemicals and pollutants — the local populace gets upset.

But a more immediate problem? One that gets local protesters out? That's the simple transportation of all that water.

There may be pipes leading to drill sites (though sometimes there aren't). But there's nothing for getting rid of the water. So most drillers store the water in big barrels — the exact same ones used for oil. Some have slightly larger tankers… and still others dig pits on-site to store the wastewater.



SOURCE: Popular Logistics

over please…

All of these solutions have major problems. Barrels require a huge amount of truck traffic and are expensive. They also upset the mostly rural populations with noise pollution, beat-up roads and unwanted traffic.

It takes trucks to get the barrels in place. It takes trucks to take the full barrels off-site. Those trucks are what's produced the biggest backlashes so far amongst locals.

But on-site pits are worse. While leaving the water in place — and reducing transportation costs — almost all local pollution is caused by leaks in these pits.

When a surface pit springs a leak — as they inevitably do — then you've got major contamination worries for the local water supply and local soil.

Luckily, one company has come up with a solution — one so simple, it's amazing no one has done it before.

Swimming pools.

No, they're not actually storing water in swimming pools, but it's surprisingly close to that. This company has developed a storage tank that can be transported easily — taken in one or two trucks, where a hundred would previously have been necessary to deal with the same amount of water.

It fits together seamlessly — and is so elegant, a small team of five or six workers can assemble it in just a few hours.

The pits heat the water if needed — a boon for fields near the Arctic in Canada. They cover the water, preventing evaporation (and, hence, concentration) in hotter, drier climates like Texas. They are above-ground — so, if a leak develops, it can be located and fixed immediately.

And, best of all, they do all this so cheaply that drillers save vast amounts of money by switching to this ecologically friendly storage system.

Regulators in North Dakota have quietly been handing out this company's business card, warning producers that new water regulations are coming… but switching to this system will satisfy all requirements.

The company is named **Poseidon Concepts (PSN:TSX)**, and it's on an incredible tear.

You see, it's important to remember that drillers are, by nature, a conservative lot. They don't want to do anything that might jeopardize production at a well.

Consequently, new technologies are slow to be adapted… but once a few major players jump in and show the play is safe, everyone follows suit.

I bring this up because Poseidon just passed the tipping point.

Last quarter, Poseidon issued guidance suggesting they'd sell a unit about every five days. Instead, they've been selling a unit a day.

In fact, demand is far outstripping supply.

Drillers are contracting Poseidon workers months in advance — and for far longer than installation takes — because they want to knock out as many wells in a row as possible, and don't want to be passed by other producers.

Simply put, Poseidon is now embarking on a monumental tear. The company just announced an accelerated program to build out more storage tanks… and still, drillers are clamoring for more.

Market penetration remains under 5%, so there's plenty of room left to run. And, perhaps best of all, Poseidon has this market all to itself.

No one else is making storage tanks like this — and it would take at least a year, and more like two or three, for anyone else to develop the same technology and reach.

Producers could do it themselves… but Poseidon does it at such an economic rate that drillers would spend much more developing a new system in-house.

Despite that, Poseidon still is pulling in profits at an unheard-of 85% margin.

Yes, you read that right.

For every $1,000 the company receives in sales… $850 falls straight to the bottom line. It's even more appealing if we look at the inverse. What costs Poseidon just $150 to make, it sells for $1,000.

That's what happens when you have no competition in your space, you provide a service everyone needs — and will soon be mandated by government — and you do it at a price no one else can approach.

There's no doubt Poseidon should be one of the best short-term gainers we'll see in the energy services sector. It's a stock just now hitting its meteoric growth phase.

But it gets better.

Poseidon also pays a monthly dividend, good for a 7.3% yield at current prices.

So, when you buy this company, not only do you get a chance to see huge gains on the back of Poseidon's parabolic growth… you also get an income play that is hard to top.

This is one of my favorite companies for 2012 — I recommend you get in immediately. ■

ACTION TO TAKE:

Buy Poseidon Concepts (PSN:TSX) up to $17.

Cleaning Up Fracking's Act

If Poseidon is well into its exponential growth phase, we're catching this next pick the moment before it hits the elbow in its parabolic curve.

And it all started at your local fast food joint.

You may remember a few years back, when one engineer, Dennis Danzik, invented a way to get biofuels out of restaurant fat and grease. It wasn't merely retrofitting cars to run on vegetable oil — this is taking grease waste and refining it in such a way you end up with usable oil products.

One energy services company — until then, almost entirely a consulting firm — noticed something interesting about Danzik's process. When you fed the grease in, you'd get petroleum… but the byproduct of the process was clean water.

Now, as we've discussed, wastewater is the biggest problem for fracking. In fact, dealing with wastewater is so difficult, most drillers just inject it into "dump" wells.

That's a problem on many levels. First, some formations, like the Marcellus in Pennsylvania and New York, have non-porous rock under their shale. You can't get wastewater to stay down there — it won't be absorbed.

Worse, if you've heard about the links between fracking and earthquakes — well, it's not actually fracking that's allegedly causing these earthquakes in Ohio and Oklahoma. It's the wastewater that's being pumped into waste wells.

This makes sense: Fracking uses the smallest amount of water possible, and uses it to split open shale. Like breaking a cracker.

Waste wells, on the other hand, are pumping in as much water as possible, into an entirely different stratum of rock. If those minor earthquakes are indeed being caused by water injection, it's this stratum that's causing the problems.

Finally, you've got the issue of taking millions of gallons of freshwater out of circulation. Once that water is left behind underground, or brought to the surface as wastewater, you're never using it again.

Enter **Ridgeline Energy Services (RLE:TSX-V)**.

Working with Danzik, they've come up with a method that not only cleans wastewater, but makes it potable.

The key is to treat the water *before* it goes underground. Using an electro-catalytic method, the water is changed at the sub-molecular level… making it repel pollutants.

Let's be clear here: Once electrically treated in Ridgeline's patented way, chemicals won't get mixed into the water. Gases won't dissolve. The water becomes less sticky — and hence an ideal way to carry hazardous materials without becoming hazardous itself.

Once back above ground, the pretreated wastewater goes through a relatively simple process to filter out all impurities. This technology even allows you to capture any oil or gas that got mixed in as the water came out of the well.

From there, it's perfectly fine to reuse the water in the fracking process… cutting down on consumption and cost. Or, if you're finished, the water can go through a standard reverse-osmosis treatment to bring it all the way back

to drinkable water, ready to re-enter the water cycle.

Wastewater. Solved.

Now, I'll admit this hasn't found wide adoption yet. As I mentioned before, oil producers are a notoriously conservative bunch, and they want to see someone else succeed with a technology before they use it themselves.

That's why now is such an exciting time.

Today, Ridgeline's technology has been field-tested on over 1,000 wells. It's being used by a number of small oil producers in northern Canada.

And, early last month, Ridgeline got its first major U.S. client — servicing larger wells in New Mexico. The company has applied for permits to do the same in Texas.

This is a HUGE deal.

The wastewater treatment system works. It's inexpensive and simple to set up the pretreatment process, which can be done very efficiently, at ambient temperature. And as treatment facilities get built throughout North America, it becomes easier (and cheaper) for other producers to get in on the act.

Once other producers see that this system does indeed work (as has been proven over 1,000 times)… and they look for solutions to their wastewater problem… they are going to jump all over this company's product.

Last quarter, Ridgeline saw revenue surge 80%. I'm here to tell you — that's going to look like small potatoes this time next year. We're getting in at the perfect moment on this play — just as it's clearing the final hurdle before mass adoption.

This is a stock you want to grab now… and then sit back and wait for the explosion upward. It's coming this year. ■

ACTION TO TAKE:

Buy Ridgeline Energy Services (RLE:TSX-V) up to $1.25.

Fracking Without Water

As I've mentioned before, as much as 80% of the water that's used in fracking stays underground.

That's not an ideal use of freshwater, but otherwise, it poses few problems. The water is deep enough that it's never making it back up to aquifers or soil; the chemicals used remain well underground, a safe distance from creating any sort of pollution problems for those of us who live on the surface.

But some shale isn't that deep underground. It's near the water table, near the soil we use to grow our food and feed our livestock. While pollutant migration from a mile deep isn't a health issue, there are some preliminary reports that chemicals used in shallow fracking may be migrating into local freshwater resources.

For obvious reasons, that's a no-go.

It's one of the reasons some towns in New York and Ohio have banned fracking altogether. And it's keeping a lot of shale gas and oil off the table.

But what if we could frack… without using water at all?

Thanks to one tiny Canadian company, today, we can do exactly that.

The business is in its infancy, but the technology it controls could change the way all fracking is done — and eliminate pollution problems.

Rather than using water, **GasFrac Energy Services (GFS:TSX)** is injecting gelled liquefied petroleum gas (LPG) into wells. This has numerous benefits.

- LPG has about half the specific gravity of water — so it is easier and cheaper to transport.
- LPG is non-reactive — meaning it won't affect the clays or salts it encounters underground, the way water does.
- LPG turns back into gas when exposed to the heat and pressure found deep underground, leaving all potential pollutants — including radioactivity — beneath the earth,

where they belong. It then travels back up the bore hole along with any recovered petroleum, so it can be reused with a 100% recovery rate.

- LPG is a natural byproduct of petroleum extraction — so, between extraction and recovery, this has the potential to be a perfect closed loop system.

What makes GasFrac's LPG special is the gelling process they apply — giving it great consistency and the perfect attributes for fracking.

It travels farther, faster — making for a shorter time from initial drill to extraction, and access to more petroleum. While it doesn't mix with surrounding geologic formations, gelled LPG does mix with hydrocarbons, making it easily extractable along with the rest of the well's find.

In short, this is the future of fracking.

A closed loop system that leaves everything bad underground, makes for faster, greater production in wells, and eliminates basically every objection from regulators and environmentalists.

However, make no mistake: Water isn't about to be replaced overnight.

The water infrastructure is in place, and gasfracking is still in its infancy. It's being used on a variety of small fields and test wells, but hasn't yet made the leap to the major players.

Consequently, gasfracking is more expensive than hydrofracturing. Until we get closer to mass commercialization, that will be the case.

But there's no doubt this is where fracking is headed.

Best of all, despite being at the very beginning of its growth curve, GasFrac Energy Services is already profitable. That's nearly unheard of for such a young company and technology — but it's true.

Last quarter, GasFrac boasted earnings of 9 cents a share — a tremendous starting point for our upward climb as this technology proceeds towards mass adoption.

It may not happen tomorrow… it may not even happen this year. But very soon, a major player will try this technology out on a significant find… and once it shows what it can do, everyone will be clamoring for it.

With these three recommendations, we're covering every step of fracking's transition to second-generation technology.

Poseidon captures a movement that has already begun and is in full swing. Ridgeline represents the absolute best way to clean up fracking the way it's done today. And GasFrac is the way fracking will be done tomorrow.

Each represents a unique opportunity in one of the greatest sectors in the markets today. Buy them with confidence, and enjoy all the benefits of the transition to Fracking 2.0. ■

To your success!

Ryan Cole
Editor, *Small Cap Insider*

ACTION TO TAKE:

Buy GasFrac Energy Services (GFS:TSX) up to $7.

IMPORTANT INFORMATION

Your May issue will be published online on Monday, April 30, 2012.

SMALL CAP INSIDER

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9 a.m. to 5 p.m. Eastern Time

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Small Cap Insider (USPS#008-0490) is published monthly for US$129 per year by The Insiders Strategy Group LLC, 16 W. Madison St., Baltimore, MD 21201, USA.

Postmaster: Send address changes to *Small Cap Insider*, 16 W. Madison St., Baltimore, MD 21201 USA.

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Small Cap Insider Portfolio

STOCK NAME	STOCK SYMBOL	ISSUE/ALERT RECOMMENDED	ENTRY PRICE	DIVIDEND YIELD	COMMENTS
Zumiez	ZUMZ	February 2012	$27.66	–	A nod to Sam Walton — Buy under $30
3D Systems (1st Half)	DDD	Weekly Alert, 2/24/12	$24.15	–	A piece of the 3-D printing pie — Buy under $22
3D Systems (2nd Half)	DDD	Red Alert, 3/6/12	$21.71	–	A piece of the 3-D printing pie — Buy at $22 or less
Poseidon Concepts	PSN:TSX	April 2012	NEW	7.30%	A niche player with a virtual monopoly — Buy under $17
Ridgeline Energy Services	RLE:TSX-V	April 2012	NEW	–	Fracking's solution to dirty water — Buy under $1.25
GasFrac Energy Services	GFS:TSX	April 2012	NEW	–	The way fracking will be done tomorrow — Buy under $7

Special Report Recommendations

STOCK NAME	STOCK SYMBOL	DATE OF FIRST RELEASE	ENTRY PRICE	DIVIDEND YIELD	REPORT RECOMMENDED
Glu Mobile	GLUU	11/28/11	$2.85	–	The Four Best Tipping-Point Trade Recommendations for Cashing In on the 'Protocol 5' Revolution
Majesco Entertainment Company	COOL	11/28/11	$2.73	–	The Four Best Tipping-Point Trade Recommendations for Cashing In on the 'Protocol 5' Revolution
Chyron Corporation	CHYR	11/28/11	$1.35	–	The Four Best Tipping-Point Trade Recommendations for Cashing In on the 'Protocol 5' Revolution
Avid Technology, Inc.	AVID	11/28/11	$6.94	–	The Four Best Tipping-Point Trade Recommendations for Cashing In on the 'Protocol 5' Revolution

New Growth Investor Portfolio

STOCK NAME	STOCK SYMBOL	ISSUE/ALERT RECOMMENDED	ENTRY PRICE	DIVIDEND YIELD	COMMENTS
ProShares Ultra MSCI Emerging Markets (holding 50%)	EEV	June 17, 2011 Alert	$32.07	–	New strategies for new market dynamics — Buy up to $33.50
Green Dot Corporation	GDOT	August 2011	$36.20	–	Court-ordered profits — Hold
Dunkin' Brands Group	DNKN	September 2011	$28.60	–	Move over, Starbucks — Use a Buy-Stop Order above $28.60
Gannett Co., Inc.	GCI	October 2011	$9.16	2.70%	"Rich Media" — Buy at $9.25 or better
LinkedIn Corporation	LNKD	November 2011	$78.50	–	Network connection — Set initial stop order at $61.20